

FINANCIAL BURDEN OF THE WAR ON INDIA

By

C. N. VAKIL

UNIVERSITY PROFESSOR OF ECONOMICS, BOMBAY

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P R E F A C E

Every one in the country, rich or poor, has to undergo sacrifices in order that the war expenditure in India may be financed. The problem that we have to face is whether this burden shall be imposed in an equitable manner so that it may fall on those best able to bear it, or whether it should be so levied that it may impinge seriously on the admittedly low standard of living of the large masses of the people in the country. The marginal standard on which large numbers of the people have to live in normal times does not admit of any diminution, if the health and vitality of the people which are none too strong are not to be so impaired that they may become easy victims of disease and death, or be compelled to live on the barest of subsistence.

The object of this book is to study the problems of war finance from this point of view and to make the Government and the public realise the growing gravity of the situation in which the country is involved by the prevailing methods of war finance. No apology is needed for one more book on the subject which has recently attracted several writers, as the problem needs the continuous thought of all concerned for a proper solution. It may be appropriate however, to review in brief the recent literature on the subject before indicating the scope of the present work.

The publication of 'The Falling Rupee' on 9th January 1943 by the present writer was followed by an unusual interest among the public in the question of War Finance. This led to the publication of a revised and enlarged edition of 'The Falling Rupee' on 9th February 1943. A public discussion in the Press and elsewhere of such a vital current problem was bound to create some controversy as it is not possible to expect unanimity

of opinion on problems which affect vested interests. It is not possible to refer to statements or articles in the daily and weekly press which devoted considerable space to this problem the leading ideas are however crystallised in the following publications —

1. *War and the Rupee* by D Ghosh, end of February 1943.
2. *Inflation or Scarcity?* by G D Birla, early March, 1943.
3. *India's Sterling Balances* by G D Birla, early April 1943.
4. *Inflation in Right Perspective* by S N Dutt, middle of April 1943
5. *The Rupee and the War* by B C. Ghose, middle of April 1943.
6. *War and Indian Economic Policy* by D R. Gadgil middle of May 1943.
7. *How India pays for the War* by K. T Shah, middle of June 1943
8. *War and Prices* by L. Nemenyi, end of June 1943.

The main thesis of *The Falling Rupee* regarding the existence and causes of Inflation is endorsed in publications 1 5, 6 and 7 Whereas Mr Birla (in publication 2) ignores the accepted economic analysis of the phenomenon of inflation, and therefore falls into the error of attributing the prevailing high prices to scarcity alone, Mr Dutt (publication 4) in his otherwise excellent essay on the Theory of Inflation misses the fact that the Government of India have brought about only a technical budgetary equilibrium by excluding from the war budgets large amounts of expenditure to finance which they have undertaken the responsibility on themselves. At the same time the emphasis put by Mr Birla (publication No. 3) and the Federation of Indian Chambers of Commerce on safeguards for the future use of our Sterling Assets shows how the propaganda carried on about these assets has drawn the attention of the commercial community more towards their doubtful value, than to the real cause of the trouble namely the inflationary methods of finance adopted by the Government of India. Most of the above publications are pamphlets publications 6 and 7 are in the form of books and attempt a fuller study of the problems of war finance Prof Gadgil's emphasis is more on the strictly economic aspects of the

question, Prof K T Shah emphasises the need for a National Government to achieve the necessary financial reform.

War and Prices (publication 8) by Mr L Nemenyi though published in the end of June, was written during the first half of March. In this Memorandum, among other things, an attempt has been made to refute the arguments advanced by me in 'The Falling Rupee', though the author appreciates the contribution made by me. It is not necessary for me to examine in detail the obviously propagandist efforts of this writer. In brief, while arguing that the financial policy of the Government of India was sound up to the time when he was writing (first fortnight of March), according to him, it would suddenly become unsound if further banknotes were issued thereafter. 'The only remedy' according to Mr Nemenyi, 'is to contract surplus purchasing power'. He further observes that 'the stage has been now reached where Governments must adopt every measure within their power to secure a contraction of currency. All recognised methods of deflation, real and psychological, ought to be brought into action without delay'. A reference will be made to this idea later.

During the Budget discussions in March the Finance Member tried to minimise the effects of inflation, though he could not deny the fact of inflation. Though the Federation of Indian Chambers of Commerce at its meeting in New Delhi during the last few days of March ignored the question of inflation, with the exception of a few remarks by the President in his opening address, it was left to Economists to draw pointed attention to the seriousness of the problem. On 12th April, a Manifesto signed by twenty economists was issued under the leadership of that veteran Indian Economist, Prof V G Kale. During the week beginning 5th April, a series of six lectures on War Finance was delivered by me at Patna under the auspices of the University of Patna as Banarasi Reader. The University of Patna was good enough to extend to me the necessary permission to publish the same. While the substance of the lectures was being revised during the summer with a view to publication, a change in the outlook of the Government of India on the problem of inflation took place. The adoption of several anti-inflationary measures by Ordinances during the month of May, accompanied by the elucidation of the same by the Finance Member before a Press Con-

ference, showed that within a few weeks of the passing of the Budget, the Government of India had become inflation-conscious. That the outlook and the method of approach regarding anti inflationary measures are not correct is shown by the recent appointment of Dr Nemenyi author of the Memorandum War and Prices referred to above as Special Officer to investigate what deflationary measures are required under present conditions to minimise the effects of the continued expansion of currency. This is a contradiction in terms. Continued expansion of currency is assumed as if it were the most natural thing. The only attempt contemplated is to minimise its effects and to do so this officer is to suggest deflationary measures. It is not realised that there cannot be any deflation unless there is an actual withdrawal of surplus currency from the circulation under present conditions. How is this to be brought about when there is continued expansion of currency? The Government of India seem to think that they can have deflation and inflation at the same time. It is a strange irony that the Government of India could be led into such gross economic fallacy. The connection between these self-contradictory terms of reference and the Memorandum of Dr Nemenyi is obvious.

It is clear however that the fact of the Falling Rupee or inflation is no longer an opinion nor a controversy. It is a fact acknowledged by the highest quarters. The attitude of ridicule or opposition has given place to that of acquiescence in a fact which can no longer be concealed. The only controversy now is as to how to go about preventing inflation. Anti inflation measures by their very nature touch different sections of the people, and if not handled properly create serious economic disturbances. Those who are in a position to influence Government policy should see that by timely criticism, the necessary improvements are made in the scope and administration of anti inflation measures. There is a disgust for all measures of economic control in some quarters. This is due to the fact that economic controls have been carried out by the Government of India in a half hearted spirit without a definite policy. The inefficiency of the administration to carry out economic controls properly so far is no argument for the continuation of inflation, which is much worse. It is rather an argument for efforts to improve the scope

of anti-inflation measures and the system of their administration including a change in the political atmosphere, in order to ensure success, because the alternative is to welcome inflation with all its horrors to Society

We have referred above to the propaganda about the sterling assets to our credit which are growing. The propaganda has assumed a peculiar feature, namely, to create the belief that these assets are there because the U K pays for the defence of India. The fact that India has become a creditor country is pointed out in this connection and we are asked to feel happy about it. This propaganda does not reveal the fact that the so-called credit is all frozen for the time being and is actually the measure of inflation in the country, which has already caused considerable economic disturbances in the country and is impinging seriously on the low standard of life of the people. It will be one of the objects of the book to expose this myth about British generosity to India.

The scope of the book may now be explained. In the first chapter, war expenditure is examined. War expenditure *in* India is not necessarily war expenditure *of* India or *for the defence of* India. The second chapter discusses the sources of revenue from taxation and from commercial services, and examines the extent and nature of war taxation. The effect of war on the public debt of India and the policy of the Government of India in this connection form the subject matter of the third chapter. The causes of inflation are analysed in chapter four which also discusses the attitude of the Finance Member on the problem. Chapter five is devoted to the evils and remedies of inflation, the remedies being classified into two categories, (a) correct methods of rupee finance and (b) anti-inflation measures. The problem of sterling assets is discussed in chapter six. Chapter seven summarises the main conclusions of the book. In some parts of chapters IV to VI, the material of 'The Falling Rupee' has been freely used, though the reader will find considerable changes in facts and treatment. Appendix I reproduces the Economists' Manifesto and Appendix II deals with the recent yarn and cloth control.

For the sake of convenience, the figures in the text are given up to the end of the financial year '1942-43. Recent figures are given in footnotes wherever possible. The amount of note circulation which was Rs 643.6 crores by the end of March 1943, is

now Rs. 737-6 crores (9-7 1943) The question may well be asked Whither the Falling Rupee ?

I am indebted to Mr D T Lakdawala, Research Assistant in Economics in this School for substantial help in collecting the material for this work, and for useful suggestions.

*School of Economics & Sociology
University of Bombay
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C. N. VAKIL.

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I

WAR EXPENDITURE IN INDIA

(1) MYTH OF BRITISH GENEROSITY TO INDIA

In connection with the war expenditure in India, in some quarters it is loosely argued that the British Government is contributing a large share towards the cost of the defence of India. As an illustration of this we may refer to the remarks of 'The Economist' on the budget of the Government of India for 1943-44. According to this leading British financial journal 'the Indian Budget is the latest reminder of the effectiveness with which India has been shielded from the war's financial strains' And further 'the counterpart to locomotives and machine tools exported to India after the war will not be current import of tea and jute but sterling handed over to the Indian Government during the war to save India from Japanese invasion. It will surely go down in the imperial record that Britain gave twice and gave quickly.'¹

That this interpretation of India's financial contribution to the war is widely believed in British circles will be evident from a few further extracts. The London 'Times' published the following statement on the Indian Budget for 1943-44.—"It (the Budget Speech of the Finance Member) also confirmed that the British Government pressed for revision of the Indo-British war financing arrangements, whereby effectively Britain pays India for India's contributions to the common war effort, while India does not pay Britain for contributions to India's defence, but the Indian Government resisted the revision and the British Government dropped the matter and accordingly present arrangements

1. Reported in *The Times of India*, 10-3-43.

stand."¹ Mr J. M. B. Gibbons, President of the Bombay Chamber of Commerce, a European body in welcoming the new Governor of Bombay at the annual meeting of the Chamber on 31st March 1943 referred to the prosperity in India in these words — "This internal prosperity finds its counterpart in the financial situation of the country as a whole, and India, from being a debtor is well on the way to becoming a creditor country." This he attributed to the fraction of India's defence expenditure being borne by herself and said that "our satisfaction might very well be tempered by the reflection that a very great measure of this prosperity and of these profits is in effect a free gift to India from the peoples of Britain and America."² The Chancellor of the Exchequer in presenting the British Budget to Parliament on 12th April 1943 echoed this view in these words — "The greater part of the additional cost of India and of the defence outside her frontiers fell upon Britain, which meant that a financial situation of some difficulty was being created for Britain in the future."

(2) INDIA'S SHARE IN THE WAR.

The above passages reflect the British attitude towards the financial contribution made by India for the war. Before commenting on this attitude, which is due to a wrong interpretation of the part India plays in the financial sphere on account of the war we shall refer to several authoritative acknowledgments of the work done by India in the military and supply fronts.

Mr L. S. Amery Secretary of State for India in a speech at Birmingham on 12th March 1943,³ referred to India's share in the war which would one day be regarded as the war's most significant feature. Mr Amery said, "India has raised a million and a half volunteers. Her divisions showed themselves second to none in all the hard fought battle fields in the Middle East. She has already played the part of the main arsenal of the Middle Eastern campaigns and is now preparing to play an even greater part in the supply and equipment of forces destined to relieve

1. Reported in *The Times of India* on 6-3-43.

2. Reported in *The Times of India* on 1-4-43.

3. Reported in *The Times of India* 13-3-43.

China and bring Japan's ephemeral conquests tottering to the ground "

A few days later, the Prime Minister sent the following message to H E the Viceroy — "We have watched with admiration the splendid achievements of the fourth Indian Division in the battle of Mareth and in the recent victory at the Wadi Akarit. The high renown of India's soldiers and of the redoubtable Gurkha troops has been enhanced by the outstanding performance of the Indian Army in all the campaigns of the Middle East.

"I take this occasion to express to the Princes and people of India and to our firm friend, His Highness the Maharaja of Nepal, our admiration and gratitude for all that the Indian Army has done in Africa, in the far East and in India itself.

"We take pride that India's fighting men should now share in the successes which have crowned the long uphill contest in which they have played so valiant a part " ¹

It is not necessary to add that eloquent appreciative comments were made in the British press on the work of the Indian Army following this message from Mr Churchill.

After the battle of Tunisia, His Excellency the Viceroy broadcasting on the Allied victory in North Africa on 13th May 1943 made among other things the following observations. —

"We shall rejoice that our famous fourth Indian Division was in at the kill. But there are many troops not now in Tunisia who won fame in Africa in 1940, 1941 and 1942, and it would be ingratitude to forget the part that Indian troops played in Field-Marshal Wavell's great campaigns and in General Auchinleck's splendid last stand that saved Egypt. It has been the joint endeavour of all troops engaged since the beginning of the African campaign that has made possible the final victory which we are now to celebrate."

"India has been a vast base for our African operations, a base from which essential supplies in huge quantities have been sent first to buttress our defence and then to crush and overwhelm the enemy"

(3) DEFENCE OF THE EMPIRE AND DEFENCE OF INDIA.

It is clear therefore that the British Government uses India as a base of operations, as an arsenal of war as a recruiting ground for lakhs of troops, and as a source of numerous supplies. It is equally clear that all these activities are primarily for the defence of the Empire both in the West and in the East, and that the defence of India is incidental. In other words, the campaigns in the west and the east to which both Mr Churchill and Mr Amery refer would not have been possible but for the fact that these huge preparations could be made in India. It is necessary to appreciate the fact that the military machine now organised in India is an Imperial affair controlled by the British Government, the Government of India acting as subordinate agents in various spheres. The fact that the effective defence of the Empire both in the west and the east has been made possible by using India as the base in this way is forgotten by confusing these activities with the defence of India, which is as said above not only incidental, but is also required for the defence of the Empire.

(4) THE IMPERIAL MILITARY MACHINE.

The significance of this state of affairs must be realised in order to understand the problem of expenditure for organising and running this Imperial Military Machine in India. The expenditure in India has to be in rupees, and the Government of India have taken upon themselves the responsibility for providing the rupee finance required for the purpose in the first instance. In practice, therefore the war activities in India which are run as one organised affair controlled by the British Government, are carried on without reference to the parties who will bear the burden of financing them in the end. Those in charge of the Military Machine in India have not to worry about the problem of the sources from which the funds they require are derived they have merely to ask for the funds in rupees which the Government of India supply.

(5) THE FINANCIAL SETTLEMENT

Having thus paid in rupees for the war expenditure in India, the Government of India then try to reimburse themselves from

the British Government for part of this expenditure. The method adopted in this connection is to determine the expenditure that should be charged to India, the balance being a British responsibility. For this purpose a Financial Settlement was made between India and His Majesty's Government regarding the allocation of the war expenditure in India between the two governments. According to this, India is to bear—

(1) a fixed annual sum, representing the normal net effective costs of the army in India under peace conditions, plus

(2) an addition to allow for rise in prices, plus

(3) the cost of such war measures as can be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interests, and

(4) a lump sum payment of 1 crore of rupees towards the extra cost of maintaining India's External Defence Troops overseas

The effect of this on the Defence Expenditure of India is seen in the following figures —

Year	Net Defence Expenditure in Crores of Rs
1937-38	47
1938-39	46
1939-40	50
1940-41	74
1941-42	
(Revised Estimates)	190
1942-43	
(Budget Estimates)	183

Japan entered the war in December 1941. The full implications of this were realised when a large slice of the Empire in the East was occupied by the Japanese, and Burma had to be evacuated. The importance of India, which was hitherto a base of operations for the Middle East, now increased more than ever not only for the defence of the Empire in the east, but also for the reacquisition of lost territories. By exaggerating the danger to India of a Japanese invasion, this important aspect of Imperial need has been often kept in the background. The story of war activities in India after the entry of the Japanese into Burma

must be studied with the clear recognition of the fact that they are designed primarily for the defence of the Empire in and through India, and the defence of India is not only a part of the larger Imperial scheme of things, but is also thus essential for the defence of the Empire.

(6) PROPOSED REVISION OF THE SETTLEMENT

With the sudden and vast expansion of the Imperial war machine in India in 1942, the expenditure also increased, and the question of revising the Financial Settlement with a view to debit a much larger share of the total expenditure to India was raised.¹ The Finance Member proceeded to the U. K. to discuss the problems that arose. Among other things he pointed out that owing to the developments in the situation since the entry of Japan into the war the cost of the measures necessary for the defence of India and for which India is liable under the existing Settlement, was so great as to impose a very heavy strain on India's limited financial resources.² Though it is now agreed that the Financial Settlement should not be disturbed, it has also been decided to adjust the new items of expenditure by an elastic interpretation of the principles of the Settlement.

(7) MILITARY PREPARATIONS DURING 1942-43

In order to have a proper idea of the additional burdens involved, we must first review briefly the new war activities which have been recently organised.³ From the beginning of 1942-43

1 "It was strongly contended by His Majesty's Government that the continued operation of the Financial Settlement between India and the U. K. would lead to an inequitable distribution of the costs of the joint efforts to defend India and the countries with which the defence of India was intimately bound up, against the aggression of the Axis powers. It was therefore proposed on behalf of His Majesty's Government that the existing Settlement should be abandoned and that in the new arrangement it should at least be stipulated that the value of equipment supplied by His Majesty's Government for the defence of India should be set against the cost of goods and services supplied by India for use in operations outside India." (Para 22, 1943-44 Budget Speech)

2. Budget Speech, Para 23

3. Based on the Budget Speech, 1943-44

but after the budget for that year was passed in the Legislature, it was decided to make "further substantial increases in all three arms of the defence services—particularly the Air arm". This was intended "to protect India against the fresh dangers to which the course of the war has exposed her". Recruitment for the army was increased to about 70,000 per month; training establishments were increased; internal communications, particularly telephone and telegraph systems were vastly extended. The housing of the additional troops, the storage of the new equipment and workshops led to great building activities. The opening of the neglected land route between India and Burma which became necessary with the withdrawal of the troops from Burma increased the engineering difficulties. To these were added 'the massive requirements' of the Air Forces.

As a result of these efforts the strength of the Army has been raised to a high figure sufficient not only for defence but also for offensive action. The basic pay and allowances of the Indian soldier as well as deferred pay were also increased.

At the same time the Royal Indian Navy has been considerably expanded. The new war vessels are used for the protection of the country. This has led to a large increase in the personnel. The facilities at the existing naval bases have been improved and new bases have been constructed. Training institutions such as a Torpedo School, Signal School, Anti-Submarine School, School for training in the handling of Landing Assault Craft etc. have been either improved or instituted.

The development in the Air Force in India has been still greater. It was decided that the Indian Air Force should be reinforced by large numbers of squadrons of the Royal Air Force, and that for this purpose, the ground and other facilities should be immediately extended on a vast scale. A comprehensive programme of aerodrome construction was pushed through at record speed, for which a million men were employed by day and night for many months. A large number of aircraft with their equipment have arrived in India, out of which squadrons are formed. The Indian Air Force has been expanded and will consist of seven squadrons during the year 1943-44. Simultane-

ously with this, anti-air craft defences have been improved. This expansion has made it necessary to have proper facilities for repairs and maintenance. The Hindustan Aircraft Company is now concentrating on these repairs, new construction is in abeyance and other repair facilities have also been created.

(8) THE THEORY OF JOINT WAR MEASURES.

As pointed out above, in practice no distinction is made whether a particular measure is for the defence of India or for that of the Empire. It is easy to point out that in most cases, the work is such that it helps in the defence of India, while defending the Empire. By the very geographical position in which India is situated, and the great strategic use to which this position is being put, it is possible to confuse the defence of India with that of the Empire. This has led to the theory of 'joint war measures'. Various measures are included in this category on the above consideration, and the cost of them is shared between India and the U K. It is not clear whether the share of both the countries is equal in each case. But it is obvious that there is great room for arbitrary decisions in such cases, which may result in increased burdens on this country.

To take an illustration, all expansions in the land forces in India are considered as one joint war measure, the cost of which is divided as under —

(a) That India would pay for raising, training and equipping from Indian resources of all land forces raised in India and for their maintenance as long as they stayed in the country and were available for the local defence of India. When they left for overseas, the cost to India of raising and training them and also of equipping them would be recovered from His Majesty's Government, who would assume all further liability for them.

(b) All imported equipment and stores for such expansion measures of the land forces from whatever source (except vehicles, armoured or otherwise, from elsewhere other than the U K.) would be provided by His Majesty's Government.¹

That all the land forces raised in India are not meant for merely the defence of India is well known. The practice has

1 Budget Speech, para 18.

been to send large numbers of these forces overseas, at the same time bring into India large numbers of white troops. The cost of the white troops which India pays is much greater per head, than that of the Indian troops sent abroad which is paid by His Majesty's Government. This proves the remarks made above regarding the defence of the Empire in and through India. In spite of this, by treating the land forces raised in India as a joint war measure, their cost is charged to India so long as they are in India. When they are sent overseas, the cost of raising, training and equipping them is to be recovered from the U K. but not the cost of maintaining them during the period they were in India waiting for service outside. It is obvious that more troops are raised in India than are required for the defence of India, though the Finance Member referred to such measures as being intended "to protect India against the fresh dangers to which the course of the war has exposed her."

Whereas the problem of the allocation of the cost of the Royal Indian Navy has not raised great difficulties, that relating to the Air Force in India has not yet been decided. The liability of India will be for "the capital outlay incurred in India on the provision of air fields and other ground and operational facilities, and the recurring costs of the squadrons and connected services while employed in India." Whether these Air Forces working from India are really defending India or the Empire is a difficult question, though there is no doubt that a large part of their work is obviously in the nature of Imperial defence. In spite of this, their entire cost so long as they operate in and from India will be an Indian liability. A limit is however sought to be put by defining the maximum air forces 'which should be considered as strictly necessary for the defence of India'. This has not yet been decided and only provisional estimates have been included in the budget for this both on capital and revenue accounts.

Regarding the activities of the Supply Department, the most important question has been that of new war factories and their cost. It is well-known that some of these factories will not have a commercial value after the war, though others may have. The arrangements made in this connection are that half the capital cost of the factories should be paid by India, and India should own all the assets. The question whether this will be to the ultimate

advantage of India in proportion to the cost cannot be determined till the exact nature of the factories, and the extent to which they can be effectively used after the war as commercial concerns are known.

These illustrations show the extent to which the burden on India has been extended far beyond that contemplated under the Financial Settlement. The vagueness and arbitrary nature of the decisions involved in this theory of joint war measures is enhanced by the very material and important factor that we are not told the exact amount that the U. K. pays under each head. What we know is the amount which India has to pay the balance, the figure of which is not published being paid by the U. K. The theory of joint war measures should at least involve this reciprocity that the party who is made responsible for one share of the cost, should be informed of the volume of the other share paid by the other party to the joint measures, so that it may be possible to form a judgment of the fairness or otherwise of the decisions in each major case.

(9) RECIPROCAL AID TO U. S. A.

Along with these financial questions, that of Reciprocal Aid to the U. S. Forces in India has to be considered. This question has remained rather vague in the past, and we are not aware of the exact nature of the arrangements made hitherto. Negotiations for a direct Mutual Aid Agreement with the U. S. A. are going on, and pending this, it has been decided to provide in the Defence estimates of 1942-43 and 1943-44 for Reciprocal Aid to the U. S. A. Whenever Lease-Lend supplies are sold to the public, Provincial Governments, Railways and Government departments run on commercial or quasi-commercial lines there is a receipt in the estimates on this account. The total amount provided in the Defence estimates for this is Rs. 16.70 lakhs for 1942-43 and Rs. 80.1 lakhs for 1943-44. The former figure is higher mainly because the capital cost of providing aerodromes for the U. S. A. forces is included in the estimates of 1942-43.

In this case also it must be pointed out that material facts bearing on the question are not revealed. For example we do not know the extent of the help received by India from the U. S. A., though the U. S. A. authorities have recently announced

large figures of such help. There is an Indian Purchasing Mission in the U S A. The Indian public have a right to know the extent of the supplies obtained by this Mission and the nature of the obligation incurred by India for the same. At the same time, it is known that some Lease-Lend supplies sent to India are on behalf of His Majesty's Government. We are not informed as to how these supplies are allocated, and to what extent, if any, this involves a reciprocal obligation on India now or hereafter. Only to the extent to which Reciprocal Aid to the U S A is made a part of the Indian Budget, we are given an inkling into the position by the provisional figures mentioned above. About the way in which the U S A receives its other finance in India, and the effect of the same on India we are kept in the dark.

In connection with a direct Reciprocity Agreement with the U S A. the questions to be determined are whether the Lease-Lend supplies received in India from the U S. A. are genuine Indian needs or are for Imperial purposes. To the extent to which these supplies are used for genuine Indian needs they should be debited to India's account, if those supplies which are not so used are also debited to Indian account, there will be an element of injustice. Having determined the value of American supplies to be debited to Indian account, we may theoretically say that India may well be asked to give reciprocal aid in return in the form of goods and services to the U S A. including rupee finance in India. But the problem is not so simple. The question is what is the real purpose of sending American troops to India? Are they required here for the defence of India? Or, are they here mainly because India is the only important base for action against the Japanese for an eventual fight for regaining control over the Pacific including the Phillipines? American prestige, American influence and also American interests in the Pacific and in China have suffered a severe blow since the attack on Pearl Harbour at the hands of the Japanese. It is to retrieve this position among other things that the U S A. entered the War and it is for this purpose ultimately that American troops are in India. If American troops are in India to help to regain British and American interests in Burma, Malaya and in the Pacific, the defence of India towards which their help appears to be given in the first instance is merely for this ultimate goal.

They must maintain in India an effective base for these future operations and not merely because they want to defend India for the sake of doing so. If this is so, is America, which is by far the richest country in the world, and which is out to defend the cause of liberty in backward areas, justified in expecting a lease lend return from India in the form of goods, services and rupee finance? Can we not expect a more statesmanlike attitude on the part of the American authorities in refusing to accept such return from the people of India in a matter which is eminently a concern of the British and the Americans?

(10) DEFENCE EXPENDITURE CHARGED TO CAPITAL ACCOUNT

Before we try to have a more concrete idea of the burdens involved in these arrangements, we should refer to a change in the form of presenting the Defence Estimates. Some of the expenditure is on items which are of a capital nature against which durable assets are held. In view of this it has been decided to separate such items into a capital account, thus nominally reducing the Defence expenditure charged to revenue. The items falling under this category are (1) capital cost of aerodromes and ground facilities (2) capital cost of industrial expansion charged to India (3) capital cost for aerodromes etc. for the U. S. A. Forces (4) capital cost of new ships for the Indian Navy and (5) capital cost of telephone and telegraph extensions chargeable to defence. It is obvious that these items are not similar to Railways under which we have a separate capital account for assets, which earn their own interest. How much of these assets it will be possible to use as commercial propositions must remain a matter of great uncertainty and for the present these charges must be considered as financial burdens of the war.

The following figures give an idea of the way in which these changes have resulted in large additions to our defence expenditure —

Revenue Account (in Lakhs of ₹)

	1942-43	1943-44
(1) Basic Normal Budget	36.7	36.77
(2) Effect of rise in prices	8.61	10.62
(3) India's war measures	13.96	17.01
(4) Non-effective charges	8.41	8.41
Total	179.73	182.81

Capital Account

(in Lakhs of Rs.)

	1912-43	1913-44
(1) Air Force—Aerodromes	18,37	2,52
(2) Capital outlay on Industrial Expansion	12,00	4,00
(3) Reciprocal aid to U S A—Aerodromes	12,75	2,85
(4) New construction for the R. I. N	4,72	3,28
(5) Capital outlay on Telephone Communication scheme	1,30	4,20
Total	49,14	16,85
Grand Total of Revenue and Capital Accounts	238,89	199,66

The large increase in the revised estimates from Rs 130 crores to Rs 239 crores is remarkable and shows the effect of the new interpretation of the Financial Settlement. The estimate for 1943-44 which is about Rs 200 crores is somewhat less, partly because most of the capital outlay was done during 1942-43; but we do not know how far this estimate will be exceeded by the end of the year, in view of what has happened during 1942-43.

The expenditure on other departments of the Government of India has also increased because of the war. This is due mainly to Civil Defence preparations, chiefly A. R. P. Services, dearness allowances, relief to evacuees, chiefly from Burma, expansion of the Supply Department and so on. The effect of the war on the total expenditure will be seen from the following table:—

Expenditure in crores of Rs¹

Year	Defence	Civil	Other	Total
1937-38	53	39	31	122
1938-39	52	39	31	122
1939-40	50	45	30	126
1940-41	75	40	36	152
1941-42	105	43	37	186
(B. E.) 1943-44	198	84	46	328
(R. E.) 1942-43	199	77	38	314

1 These figures include all expenditure shown in the budget as on Revenue Account, in which the interest payments on railway capital and the whole revenue expenditure on the Post and Telegraph Department are included.

(11) THE LIMIT OF INDIA'S CONTRIBUTION TO WAR.

This rapid survey should convince any one conversant with the poverty of the people of India, their low standard of living, and their limited taxable capacity that India has been made to pay heavily towards the cost of the war, and that her financial contribution is of no less importance than that in men and materials. In fact, in using India as the strategic base for the war both in east and the west, the British Government have tried their best to see that India contributes financially to the point of squeezability¹. The manner in which the British Government tried to change the Financial Settlement in order to produce from their point of view an equitable apportionment of defence liabilities was briefly explained by the Finance Member². The proposal to modify the Financial Settlement has been dropped, out of which the Finance Member has tried to create a psychological satisfaction. He has however not revealed the obvious connection of this decision to the large increases in our financial liabilities. Is it not proper to infer that with the threat of a modification of the Financial Settlement, the British Government obtained the transfer of as much of the war expenditure in India as possible to India by the various devices which have been already explained, and that the threat was withdrawn when they found that a revision of the Settlement would not be more advantageous to them than what the Finance Member offered by the ingenious interpretation of the existing Settlement by includ

1. Replying to the general debate on the Budget for 1943-44 the Finance Member dealt with the question whether the Government of India in agreeing to the Financial Settlement, had kept in mind the financial capacity of India. "His answer was emphatically in the affirmative. He would go so far as to say that by no other criterion could this settlement be justified. *There was no argument of logic—except inability to make a larger contribution—which would allot to India so small a share of the cost of defence against a genuine and imminent danger*" (Italics ours)

Obviously there was no measure by which the ability of India was determined. The only limit was the point at which the inability to make a larger contribution began in the opinion of the Finance Member. This explains the fact that India contributes to the point of squeezability. Cf. "Briefly absolute taxable capacity is the limit of squeezability" Science of Public Finance by G Findlay Shirras, third edition, p 229

2. Budget Speech, 1943-44

ing in it 'joint war measures and similar other things already discussed ?

(12) WAS BRITAIN GENEROUS TO INDIA IN THE PAST ?

It is necessary to emphasise this point because of the way in which responsible parties in the U. K. are trying not only to ignore the financial burden of the war put on India, but are also creating the wrong impression that the U. K. has been so generous that it is paying for the defence of India. It would be appropriate here to point out that this claim of British generosity towards India is not borne out by history. It may be recalled that the debt of the East India Company incurred for the conquest of India was turned into the public debt of India. The debt incurred for the suppression of the Mutiny of 1857 also became part of the Indian Public Debt. The interest on the East India Stock and the payment of part of the principal at the rate of £ 200 for every £ 100 were debited to India. It is well known that the Indian Army has been maintained as a part of the Imperial Army and has been available for expeditions with which India has had no connection. The use of the Indian Army overseas for such purposes in the past became a subject of criticism, the more so because part or whole of the expenditure for such purposes was debited to India, often against the wishes and protests of the Government of India themselves¹. During the last war of 1914-18, the ordinary cost of Indian troops sent overseas was borne by India²; in addition to this special war contributions amounting to Rs 150 crores in 1917 and Rs 216 crores in 1918 were paid by India. With the growing political consciousness in the country, and the declaration of gradual self-government, it was realised that the fact of the Indian Army being a part of the Imperial Army could no longer be concealed. Anticipating that the control of civil power in India will have to be transferred as soon as possible, the British authorities thought of arranging for an effective military control in India, partly for strategic reasons and partly in the interests of British trade and industry. When the Chatfield Commission came to the conclusion

1. For a fuller account of this problem, see C. N. Vakil, "Financial Developments in Modern India", pp. 125-137

2. Page 135 Ibid.

that the Indian Army should be mechanised it was also recommended that a large part of the cost should be met by the British Government. This was on the one hand a recognition of the long existing but concealed fact that the Indian Army was part of the Imperial Army that it should now be openly treated as such and on that account the additional cost be borne by the British Government. It was well known at the time that there was no threat to India then requiring mechanisation of Indian troops these preparations in India were part of the sudden war preparations in England and the Empire because of the failure of Britain to appease Germany and the prospect of a world war in which such mechanised Indian troops could be used. They are being used now in Africa and elsewhere with great effect. Naturally the control of the Army would remain with the British who now also paid for it partly and thus this silent revolution in the status of the Indian Army as being openly under the control of the British authorities, independent of the popular element in the Government of India now and independent of the National Indian Government of the future, was brought about.¹

(13) THE THEORY OF IMPERIAL DEFENCE.

With the outbreak of the War when the Financial Settlement for war expenditure was adopted it was made in pursuance of the same general policy mentioned above. Expenditure which might be considered necessary for the defence of India or for "purely Indian liabilities" was estimated by the new formula and this was debited to Indian account. In practice the expenditure on the military establishments in India—land air or sea—is decided mainly on Imperial considerations. The plans and estimates have little relation to the needs and capacity of India. The defence needs of India are covered in the larger Imperial scheme of things the capacity of India is defined by the Financial Settlement she will pay the amount thus due from her and the rest will be found by the British Government. We have already seen how the vast and elastic limits of interpretation of the existing formula have been used and huge additions have been

1 The amount paid by the U. K. for this purpose was £ 25.5 millions, and a loan of £ 8.5 millions without interest which is to be repaid soon as part of the debt repatriation scheme.

made to the military budget of the country.¹ It should be clear that the British Government are not paying for the cost of the defence of India, rather India is helping them to defend the Empire in the sense that the huge defence expenditure actually borne by India is a deduction from the total cost of Imperial defence in and through India.²

Besides the war expenditure *in* India, which thus becomes the defence expenditure *of* India, India further makes a substantial financial contribution to the war by providing the rupee finance for that portion of the war expenditure in India, which is debited to His Majesty's Government. Though India is ultimately reimbursed for this in sterling, the method of finding the rupee finance and the use of the sterling received in lieu of the same in England, involve a heavy burden on the country which has not been appreciated by those who harp on the so-called generosity of the British Government in the financing of the war expenditure in India. The same applies to the rupee finance provided for other allied nations. For example, if we have a dollar credit for rupee finance given to the U S A the same would be transferred to the U K and we would get a credit in sterling.

(14) EXCLUSION OF MATERIAL FACTS FROM THE BUDGET

As already explained the entire war expenditure in India is

1 Cf " Though no definite forecast is possible, it is obvious that there are vast and elastic limits of interpretation under the existing formula, which in view of the war situation in the East and the difficulties of financing the same from England, may result in substantial additions to the military budget of the country, unless the Indian members of the Viceroy's Council are able to prevent the same, because the Assembly as at present constituted can have no effective voice in the matter" (C N Vakil *The Falling Rupee*, second edition, p 20)

2 Incidentally this explains why during the Cripps' negotiations control of Defence was kept in reserve as the only item which could not be transferred to a national government. At present the only distinction between Imperial and Indian defence is in the matter of allocating expenditure, in all other respects it is wholly an Imperial affair. The fact that the Defence Expenditure which was more than half the Central Budget in normal times was not subject to the vote of the Assembly is also explained by this theory. Ibid page 19

The fact that the Military, Naval and Air Chiefs of India had to attend the Roosevelt-Churchill meeting at Washington in the middle of May also supports the theory of Imperial Defence outlined above.

financed by the Government of India in rupees the allocation of expenditure between India and the U K. is a matter of accounting which takes place afterwards in the manner explained above. The ways and means position of the Government of India is thus affected not merely by its own budget requirements, but by the entire cost of the war in India including that portion which is charged to His Majesty's Government and the allies. It is an irony of war finance in India that the entire ways and means position of the Government of India thus affected is not even placed before the Legislature, and we are kept completely in the dark as to the amounts involved. If the true ways and means position of the Government of India for financing the total war expenditure in India, irrespective of its allocation, were revealed, we would at once find that the Government of India is in the same position as some of the belligerent countries in the last war who financed their war expenditure by printing additional currency notes. The fact that this essential part of the financial activities of the Government of India is thus concealed in no way absolves them from the fact that inflationary methods of finance are adopted. Instead of being told directly as to what exactly is done in this matter we are left to infer the facts, from the figures of the Issue Department of the Reserve Bank of India which show large increases in the issue of currency notes, against sterling securities, in which the sterling payments received from the British Government are invested.

Whereas in the U S A. and the U K. the entire cost of the war howsoever incurred is made public, this practice of not publishing the correct ways and means budget of the Government of India has misled not only the British public into the myth of British generosity towards India but the Finance Member himself has become a victim of the self-delusion thus created. In his reply to the general discussion on the budget, he observed that "the sterling balances arose not only from goods exported out of the country or services rendered in other theatres of war but that, in so far as under the Financial Settlement with His Majesty's Government the whole cost of the defence of India was not borne by India, the remainder of the cost of defending India and the measures taken in India became part of the sterling balances." The problem of sterling balances will be treated at length later

but after squeezing the people of this country both directly by taxes and loans, and indirectly by inflation to their utmost capacity, instead of making a generous acknowledgment of the enormous financial contribution that India makes towards the defence of the Empire with reference to her limited capacity, it is a misfortune of this country to be told by the Finance Member himself that India does not bear the whole cost of her own defence. What greater proof is required for the confusion thus caused between the defence of the Empire in and through India on the one hand and the defence of India on the other hand even in the highest quarters in the financial sphere?

(15) CONCLUSIONS

The conclusions of this review are -

(1) That the war expenditure in India has grown enormously because India is the base of operations in the east and in the west for the Imperial war machine.

(2) That the total disbursements in rupees in India for the entire war activities are not shown in the ways and means budget, and that this practice leads to a wrong perspective regarding India's financial contribution to the war, so much so that some responsible parties have wrongly claimed that the U K is paying for the defence of India

(3) That India is made to pay to the point of squeezability for this expenditure on her own account, for which she has to raise more taxes and loans

(4) That India has to find the balance of this expenditure mainly by printing additional notes, the adverse effects of which on the economic life of the country are being already felt and will be disastrous in the end as will be explained later,

(5) and that therefore the U K instead of being generous towards India as claimed by some, has fully utilised her Imperial position in India in the financial sphere as much as in others, without due regard to the effects of the same on the people of the country

II

TAXATION AND REVENUE

A. TAX REVENUE DURING THE WAR.

The total expenditure of the Government of India increased from Rs. 122 crores in 1938-39 to Rs. 260 crores in 1943-44 (Budget) that is an increase of Rs. 138 crores or more than a hundred per cent. These figures do not include the expenditure on Commercial Departments shown in the revenue account, as this is met from the receipts of these departments. Two-thirds of this excess of Rs. 138 crores or Rs. 98 crores has been met from an increase in revenue, the remainder being accounted for by loans or other sources to be discussed later. This increase in revenue has been brought about by several changes in taxes as well as by other factors spread over the war period. The increase in revenue may be divided into (1) that due to taxes and (2) that due to commercial services. Taxes will account for Rs. 60 crores of this increase in revenue for 1943-44 the balance of Rs. 38 crores being due to commercial services.

(1) EFFECTS OF THE WAR ON EXISTING TAXES.

Before considering additions to taxation, we shall first take note of the effects of the war on the taxes that were in existence at the outbreak of the war. In some cases, the war leads to an automatic increase in revenue. In others to a decrease. Because of the new avenues of employment which the war creates both in the fighting forces and in the supply services, there is an increase in the income of certain classes of people leading to an increase in the proceeds from Income Tax. The yield from ordinary Income Tax has increased from Rs. 152 crores in 1938-39 to Rs. 22 crores in 1943-44. These figures do not show the full

extent of the increase in revenue under this head, which would have otherwise occurred, but for the Excess Profits Tax. The Excess Profits Tax is a first charge on excess incomes, and for the purposes of Income Tax the income is computed after deducting from the net income the amount of Excess Profits Tax paid by the assessee. The war has also led to an increase in the earnings of corporations. The ordinary corporation tax levied at double the pre-war rate is expected to yield Rs 88 crores in 1943-44 compared with Rs 2 crores in 1938-39. The Excess Profits Tax on corporations is put down at Rs 33.8 crores for 1943-44. In this case also the ordinary tax would have yielded more if the new tax had not been imposed because of reasons already pointed out in the case of ordinary income tax.

As against the increase of the yield on taxes on income, the effect of the war on Customs Duties is that of a substantial decline in revenue. The cessation of trade with enemy countries, or countries under enemy occupation, the great difficulties in the trade with neutral countries, the huge shipping losses, the shortage in shipping space available for private trade, and the control of exchange as well as of imports and exports have all combined to bring about a shrinkage in our foreign trade, with the consequence that the yield from Customs Duties has fallen. In spite of the fact that the rates of duties have been increased, Customs Revenue fell from Rs 40 crores in 1938-39 to Rs 30 crores in 1943-44. Because of the shortage of certain articles such as petrol, kerosene, sugar and matches on which Central Excise duties were in existence at the beginning of the war, the revenue from this source would have gone down, but for the increase in rates on some of the existing excises and the imposition of new excise duties.

(2) NEW TAXES (a) EXCESS PROFITS TAX

The mobilisation of supplies for war at short notice creates numerous problems. Because of the shrinkage in foreign trade, the absence for certain types of goods which were formerly imported is felt. It also becomes necessary to take steps to utilise locally those goods which were formerly exported. New industries are suddenly brought into existence irrespective of their commercial character; these give rise to subsidiary industries. On

account of the great and increasing demand for all sorts of goods and the difficulty of organising the supply of the same, prices of such goods naturally rise. Part of the supplies of war must be at the cost of civilians, who find that the supplies available to them are diminishing. The inevitable rise in prices due to these unavoidable factors during war time is further increased in those countries which resort to inflation as a method of war finance. The additional currency notes with which the Government buys the supplies become part of the circulation and their distribution is most uneven. The increased quantity of money thus created exchanges against the diminished quantity of goods, which thus becomes an additional general factor for a further large rise in prices.

Those who are in a position either to manufacture goods for war or to undertake to supply such goods as contractors find themselves in possession of huge windfall profits due to the rise in prices, which is often of a continuous nature particularly under inflationary conditions. The persons in this fortunate position thus reap where they have never sown, because the profits which they receive are not due to any special foresight or intelligence on their part, but are mainly due to war. It is natural, therefore, that the state should see that large fortunes are not amassed by a few out of the national calamity due to which most people have to suffer in various ways. This is the justification of the Excess Profits Tax which is a feature of the financial system of all belligerent countries.

In his speech introducing the Excess Profits Tax in 1910, the Finance Member observed that "it was just that in raising additional revenues necessary to cope with this additional expenditure Government should tax the increased profits which like increased expenditure arose out of the war". The rate of the tax was 50 per cent. this was increased to 66½ per cent in 1911-42. In the U. K. the Excess Profits Tax rate is 100 per cent, though 20 per cent. of the tax paid as a sort of deferred savings.¹ In India the Excess Profits Tax is levied on incomes above

1 A similar arrangement on an optional basis was introduced in India this has been made compulsory recently this will be discussed in the chapter on Public Debt.

Rs 36,000 In the case of industries established after 31st March 1936, a percentage basis is laid down¹ Regarding losses and hard cases, the same general provisions as in other countries have been made. So far as the basis for the calculation of standard profits is concerned, there was a great controversy about the selection of the standard period The incidence of the tax would obviously vary with the period of standard profits In order that the period may be as near the outbreak of the war as possible, and yet be unaffected by it, great care has to be taken In the U K the years 1935 and 1936 or the average of either with 1937 has been adopted as the standard period In India there were no war preparations even in 1938-39, though this year was not allowed to be taken as the basis for calculating standard profits The standard period in India is Income Tax years (a) 1936, (b) 1937, (c) 1936 and 1938, (d) 1937 and 1938 and (e) 1938 and 1939 This put certain businessmen in whose case the effects of the Great Depression had not yet disappeared to a disadvantage

(b) INCOME TAX AND SUPER TAX

In the budget for 1940-41, these taxes were not touched though a warning was given by the Finance Member that the tax payers might be called upon to pay more A supplementary budget was introduced in the middle of the year when a central surcharge of 25 per cent was levied both on the Income and Super Taxes This was subsequently increased further from time to time In the budget for 1941-42, the surcharge was raised to 33 $\frac{1}{3}$ per cent, in the following years it was raised to 50 per cent in the case of incomes above Rs 15,000, and to a still higher figure in the case of incomes below this level This anomaly was explained by the Finance Member in these words "The basic tax progresses from $\frac{1}{4}$ th of an anna at one end to 9 $\frac{1}{2}$ as in the rupee at the other The scope for feasible enhancement of the latter rate of tax in a time of national emergency is clearly much more restricted in terms of a flat percentage than the increases

1 The percentage laid down is 8% in case of companies, except where the directors have a controlling interest, and 10% in other cases In case of firms commencing work on or after 1-7-'38, the percentages are raised to ten and twelve respectively

which are feasible in the lower reaches of the scale.¹” In the Budget for 1943-44, the surcharge was further increased in such a manner that the central surcharge will now be 66 $\frac{2}{3}$ per cent. of the basic income tax rates. In the case of Super Tax a uniform increase of half an anna in the rupee has been made. The new rates of Income Tax and Super Tax will be found in Appendix I to this chapter. The surcharges are expected to yield an additional revenue of Rs. 16 crs. during 1943-44.

A few other changes made in the budget for 1942-43 may be noted. The exemption limit for income tax was lowered from Rs. 2000 to Rs. 1500. Besides a scheme was made to bring about savings in the case of certain income tax assesses. This will be discussed in the next chapter.

(i) *Suggestion for relief from Income Tax.* While taxes on income conform to the principle of ability and are therefore better than other forms of taxation, there are occasions when it may be necessary to introduce relief in the income tax on certain classes of people on the very principle of ability to pay. Under the prevailing conditions in the country all classes of people suffer to some extent because of rising prices. The suffering is the greatest in the case of those who are not able to obtain a higher money income in proportion to the rise in prices, because they will find that the real value of their original income is falling thus lowering their standard of life. This is eminently true of those income tax assesses who are in the lower grades say those whose incomes are below Rs. 6000. A large majority of this class are likely to be persons with fixed incomes whose capacity to pay income tax is fast disappearing, if it has not disappeared already. It is on the grounds of ability to pay that the taxable minimum should be raised to at least Rs. 3000 and those with incomes below Rs. 6000 should be charged the lowest possible rates of tax. Whereas in the case of those persons who are able to earn more because of the war the question is of diverting their excess purchasing power either by taxation or by postponing its expenditure the question with reference to the above group of persons with fixed incomes is to restore to them at least some purchasing power which they have lost because of the war for no fault of their own.

1 Budget Speech, 1941-42, para 41

To continue to tax this class of persons at the former rates and with the addition of the surcharge is highly inequitable according to all canons of taxation

(11) *Ceiling on Higher Incomes* While advocating this relief, we may point out that it is possible to raise more revenue from the rich who are able on account of the war to add to their income, and who are still left with large incomes even after paying the present taxes. At a time when the large masses of people have to undergo a severe reduction in their standard of living due to rising prices, it is not proper that the few rich should be in a position to spend more and thus take away for themselves a larger proportion of the available reduced stock of essential goods. Appendix II gives figures which show the amount of income left to persons in different grades of income after paying the taxes with the recent changes. A comparative table for the U. K. shows the corresponding position in that country. In case more revenue is required to make up for the gap caused by the suggestion made above, or for any other reason, the parties who should be first taxed are the rich few, say those who are left with more than Rs. 50,000 after paying the taxes at the new rates. This will be in accordance with the principle of ability to pay and in conformity with the practice of other countries during war time.

(111) *Provincial Share of Income Tax* In connection with the Government of India Act of 1935, it was laid down that the provinces should have a share in the proceeds of Income Tax. This was done because the sources of revenue at the disposal of the Provinces were inelastic whereas the scope for expenditure by them on nation-building activities was unlimited. At the time the new constitution came into operation, the Central Government was in difficulties because of deficits in railway finance, which meant that the railway contribution to the general revenues was not available. Sir Otto Neimeyer who was asked to suggest a division of resources between the Centre and the Provinces, recommended that the Centre should retain from the share of Income Tax which was to be ultimately given to the Provinces,¹ a part which along with the railway contribution would make up

1. Half the proceeds of Income Tax

a total of Rs. 13 crores. With the outbreak of the war central expenditure increased and the main source of central revenues, namely Customs declined. The Central Government had to depend on additional income tax among other things. Contrary to the spirit of the Federal Constitution, a change was made in the *Neimeyer Award* in 1940 by an *Order-in-Council*, whereby the Centre was to retain from the Provincial share an amount of Rs. 4½ crores. This order was for three years in the first instance, but has been now extended. In effect, this amounts to a contribution by the Provinces of Rs. 4½ crores to the Centre for the war.

(c) CORPORATION TAX.

The Corporation Tax was also increased along with the increases in taxes on income. In the supplementary budget for 1940-41 a surcharge of 25 per cent was levied this was increased to 33½ per cent in 1941-42. The tax was raised to 1½ *na.* in the rupee in 1942-43, and raised to 2 *na.* for 1943-44. The proceeds from this tax rose from Rs. 2 crores in 1938-39 to Rs. 8.8 crores in 1943-44.

(d) CUSTOMS DUTIES.

Customs Duties was the largest single source of revenue for the Central Government before the war the yield from it being more than Rs. 40 crores out of a total central revenue of about Rs. 122 crores or nearly one third of the total revenue. This was larger than the Land Revenue of all the Provinces put together and it may therefore, be considered as the largest source of revenue for the whole country. With the outbreak of the war the Customs revenue showed some increase and amounted to nearly Rs. 46 crores in 1939-40. This was perhaps due to the abnormal activities of increased imports during this year. But with the prolongation of the war the increasing shipping difficulties and the restrictions on trade, the trade was bound to suffer with consequent diminution in the yield from Customs Duties. At the same time other taxes, particularly on income were raised, thus reducing the relative importance of Customs Duties as a source of revenue.

An effort was, however made to make up for the reduction

in revenue by an increase in the duties. The duty on raw cotton was doubled in the budget for 1939-40, this was expected to bring Rs 55 lakhs a year. In the budget for 1941-42, the alternative specific duty on artificial silk, silk yarn and thread was increased from 3 as to 5 as per lb. This was estimated to yield Rs 36 lakhs. In 1942-43, a general surcharge of 20 per cent was levied on Customs Duties with a few exceptions such as raw cotton, motor spirit, salt etc. This was expected to yield Rs 570 lakhs. At the same time, the import duty on those articles on which the excise duty was increased was automatically raised. In spite of these changes, this source of revenue is estimated to yield Rs 30 crores in 1943-44 as against Rs 44 crores in 1938-39. It may be pointed out, however, that after the cessation of hostilities, when foreign trade once again becomes normal, Customs Duties will yield more revenue. Whether it will regain its former position will depend on the changes in the other sources of taxation that may be made after the war.

(e) CENTRAL EXCISE DUTIES

The Central Excise Duties have shown a remarkable increase in revenue from Rs 87 crores in 1938-39 to Rs 253 crores in 1943-44 or nearly three fold, thus more than making up the loss in Customs revenue. This has been achieved by increasing the rates of tax on the existing items and by adding to the list of these items new articles. The excise duty on motor spirit was raised from 10 as to 12 as in April 1940, and to 15 as in April 1942, leading to an increase in revenue of Rs 1 crore. In 1940-41, the excise duty on sugar was increased from Rs 2 to Rs 3 per cwt, yielding an additional revenue of Rs 3 crores. The duty on matches was doubled in 1941-42 which was also estimated to bring Rs 3 crores. In 1942-43 the excise duty on kerosene was increased from 2 as 9½ pies per gallon to 3 as 9 pies or to the level of the import duty, and the duty on silver was raised from 3 as to 3 as 7½ pies.

The new excise duties are on tyres and tubes levied in 1941-42, in 1943-44 a duty of Rs 5 on vanaspathi ghee, and duties on tobacco expected to yield Rs 10 crores were levied. The duty on vanaspathi ghee and tobacco will fall more heavily on the poorer classes, this was indirectly accepted when the rate on the

former was reduced from the original proposal of Rs. 7 to Rs. 5 per cwt. The ordinary man in the rural areas is used to tobacco almost as a conventional necessity and will have to pay the duty because he will not find it easy to give up his habit.

(3) THE TAX STRUCTURE.

The aggregate effects of these changes can be seen on the structure of central taxation. The following table gives the relative position of the different categories of taxes before the war and in 1943-44

Year	<i>Figures in crores of Rs (Percentages in Brackets)</i>			
	Business Tax ²	Direct Taxes	Indirect Taxes	Total
1938-39	2 (2.7)	14 (18.9)	58 (78.4)	74
1942-43	30 (24.6)	37 (30.3)	55 (45.1)	122
1943-44	43 (27.6)	47 (30.1)	66 (42.3)	156

This table shows how the Central Government depended largely on indirect taxes before the war whose burden is more on the poorer section of the people. The relative decrease in the percentage of indirect taxes and the increase in direct and other taxes shows that the burden of taxation is now better distributed than before, though the actual burden has increased because of the need for more revenue and the imposition of more indirect taxes. It is interesting to point out that since 1937 a similar tendency is observable in the tax structure of the provinces, where steps have been taken to see that the burden may fall on those most able to bear it.³ The difference however is that the changes

1. This table is subject to modification as explained later in this chapter

2. The Corporation Tax including that from E. P. T. on corporations is shown here separately as Business Tax. Though a direct tax, it has no relation to individual ability

3. Cf. Finance under Provincial Autonomy C. N. Vakil and M. H. Patel, p. 144.

in taxation in the provinces were made with the object of spending more on the social services, which in effect amount to a transfer of some purchasing power in kind from the rich to the poor. The changes in taxation in the Centre have been forced by the war and the expenditure does not lead to ameliorative effects on the people. Besides, it is quite possible that some of the emergency taxes such as the Excess Profits Tax will go after the war and Customs will increase, thus bringing about a change in the tax structure, unless steps are taken to see that the structure is maintained with a view to a more equitable distribution of the tax burden. It is well known that the Indian tax system was on the whole regressive before the war, and it would be desirable that the situation which now exists both in the Centre and the Provinces, which indicates a more equitable distribution of the tax burden as between the different classes is further developed in the right direction, and not allowed to relapse into the old system.

B REVENUE FROM COMMERCIAL SERVICES

The contribution to the general revenues made by the Commercial Departments of the Government of India, the Railways, the Posts and Telegraphs, and Currency and Coinage has increased both absolutely and proportionately since the war. From Rs 16 crores in 1938-39, the total contribution increased to Rs 25.5 crores in 1942-43, and is estimated to amount to Rs 33.9 crores in 1943-44. In spite of the increase in tax revenues, the percentage contribution of these commercial departments to the total revenue has increased from 2.1 per cent in 1938-39 to 17 per cent in 1942-43 and 1943-44. This phenomenal growth is due partly to the circumstances created by the war which have led to an increase in the demand for these services, partly to an increase in rates and changes in the method of distribution of the net receipts from these departments. We shall examine the actual details in each case separately.

(1) RAILWAYS

The Railways constitute the most important of the commercial departments, and are responsible for the greater share of the increase in revenue from these departments. The contribution to the general revenue made by the Railways increased from

Rs. 1.4 crores in 1938-39 to Rs. 20.1 crores in 1942-43 and Rs. 27.1 crores in 1943-44. This increase is due to (1) an unparalleled rise in gross earnings accompanied by only a small rise in working expenses (2) an increase in rates and (3) a change in the convention by which the relations between the Railway Finance and General Finance were governed hitherto.

(a) *Increase in gross earnings* The progress of the war and the use of India as a base of allied operations both in the east and the west have led to an unusual increase in the amount of traffic offered to the railways. The movement of troops along with their heavy equipment, the building of a large number of military works, the movement of other war supplies are among the causes leading to this situation. For example, during 1942-43, more than 400 special troop trains were run every month, and about 15 million tons of military traffic was carried.¹ The increase in industrial production due to the war is an additional cause for greater demands on the railway services. The movement of population which takes place either for war work or sometimes due to war scare adds to the difficulty. The strain on railways has been enhanced by the embarrassing extent to which other means of transport had to be curtailed. The coastal traffic has practically ceased as most of the ships have been chartered for war.² the motor traffic has suffered because of the shortage of petrol and more recently also of tyres, tubes and trucks.

The railways were in a singularly bad position to meet this sudden demand. During the depression, retrenchment had been forced on the Railway administrations with the consequence that the operating capacity of the railways had gone down. The only additional traffic which the railways could carry without difficulty was the usual increase in the busy season over the slack season. Besides, when the new demand appeared with the outbreak of the war the railways were not in a position to increase their carrying capacity. This was so because they could not obtain new locomotives and wagons which were mainly imported.

1 Railway Budget Speech, 1943-44, para 2.

2. An idea of this strain can be had from the fact that the movement of coal by rail instead by sea-rail route meant a 20 per cent. increase in pre-war traffic. (Railway Budget Speech, 1940-41 para 2)

for meeting the new demands. Under the circumstances, the existing resources ought to have been conserved by speeding up repairs, and efforts ought to have been made to manufacture railway materials in the country. This was however not done. In spite of the favourable report of two officers appointed by the Railway Board to examine the possibilities of building broad gauge locomotives and boilers in India,¹ nothing was done to manufacture them in India. The repair work could not be speeded up, as some of the railway workshops were diverted to the manufacture of munitions. At the same time, the lack of materials greatly hindered the work that was already being done. For example, the locomotives built at the Ajmer workshop fell from about 15 to 9 in 1941-42,[†] and even these could be built only with the materials obtained before the war. Even in the case of locally produced goods, the railways could not obtain adequate quantities, for example, only 50 per cent of their demand for steel was met in 1941-42. To these difficulties for meeting the unusual war demand were added others, which were entirely due to the indifference of the Railway Board to the needs of the country. They parted with 200 locomotives, 1000 wagons and 1576 miles of railway track and large numbers of skilled personnel to be sent out of the country at this very juncture.

In consequence, the railways could meet only a part of the total demand made on them. Even this was done by great efforts in organising a more economical use of wagons. The Wagon Pooling scheme was extended and made compulsory for all railways. A special officer was appointed for the purpose specially to look after wagon facilities for coal. This naturally meant that more work was taken from wagons and locomotives. For example, in the case of wagons the work increased from 351 freight ton miles to 392 per wagon and in the case of locomotives from 15,000 to 17,000 miles per each locomotive.² By these and other methods, the railways managed to handle a 30 per cent increase in ton miles of goods and a 16 per cent. increase in passenger miles in 1941-42. At the same time, steps were taken to reduce the strain on railways by propaganda for the economy

1 Railway Budget Speech, 1940-41, para 13

2 Railway Budget Speech, 1942-43, para 5

of wagons and for essential travels only. Passenger trains were reduced by 27 per cent. all concession rates were cancelled, priority systems were evolved. cross movements were prevented and efforts were made to rationalise all means of transport. In spite of this, the traffic has not been reduced to the level which rail ways can bear and therefore goods traffic has to be closed on certain days, and passengers have to travel in the most congested trains. The difficulties are reflected in the fact that in 1942-43, compared with the preceding year the number of wagons loaded decreased by 15 per cent. on broad gauge and 17 per cent. on metre gauge though the freight ton mileage was less by 10 per cent. only.

(b) *Increase in Rates* —Though the railways have been able to meet only a part of the total demand, their gross receipts increased considerably. The receipts were further augmented by an increase in rates and fares. From March 1940 an increase in passenger fares of $6\frac{1}{2}$ per cent.¹ and in goods freight of 12½ per cent. was made. Foodgrains, fodder manures and military traffic were exempted from this increase. In the case of coal, the surcharge was increased to 15 per cent. upto November 1940 and for coal movements after that date to 20 per cent. Further changes were introduced in the budget for 1942-43. In the case of foodgrains being less than a full wagon load a surcharge of 2 aa. in the rupee was levied. For parcels and personal luggage, the surcharge was raised to 25 per cent. The rates on the E. I. and N. W. railways which were hitherto less than those on other lines, were increased. The effects of all these changes on the gross receipts are very satisfactory. they rose from Rs. 98 crores in 1938-39 to Rs. 149 crores in 1942-43 and are expected to amount to Rs. 150 crores in 1943-44. The working expenses have increased less, from Rs. 67 crores in 1938-39 to Rs. 87 crores in 1942-43. The net receipts have thus increased from Rs. 32 crores to about Rs. 64 crores. After paying the interest charges on railway debt, the net profits have increased from Rs. 2.8 crores in 1938-39 to Rs. 36.3 crores in 1942-43 and are estimated at Rs. 36 crores in 1943-44.

(c) *Railway Contribution to General Revenues* —The allo-

1. Fares upto rupee one were not touched.

cation of railway surpluses between the Railways and the General Revenues was governed by the Convention of 1924. The Railways were to contribute (1) one per cent on the capital at charge on commercial lines (excluding capital contributed by companies and Indian States) at the end of the penultimate financial year, plus one fifth of the surplus profits left after this payment was made. No surplus profits were deemed to have accrued until the past liabilities to the general revenues were paid (2) The interest on the capital at charge, and the loss in the working of strategic lines, was to be borne by the General Revenues, and was therefore to be deducted from the above contribution (3) If the surplus remaining after the contribution to General Revenues exceeded Rs 3 crores, one third of the excess was to accrue to the General Revenues

This Convention worked well only for a few years, 1924-25 to 1928-29. In 1929-30, the one per cent contribution to General Revenues could not be paid without drawing on the Reserve Fund, from 1930-31 to 1935-36, there were deficits and even the interest charges could be paid only by drawing on the Reserve and Depreciation Funds. The Reserve Fund was wiped out by 1931, and loans from the Depreciation Fund were the only remedy. By the end of 1935-36, loans of about Rs 30½ crores had been taken from the Depreciation Fund. Under these conditions, the question of contribution to General Revenues could not arise and the liabilities began to accumulate. In 1936-37, a small surplus of Rs 1-2 crores accrued, but since the loans from the Depreciation Fund had to be paid off first, the General Revenues did not get anything. If this arrangement had continued, the General Revenues whose arrears by 1936-37 amounted to Rs 30.7 crores would not have gained anything for a fairly long time. Hence, in the year 1937, a decision was reached to write off both the past contributions to General Revenues and to the Depreciation Fund. On mature thought, however, only a three years' moratorium suspending payments of past arrears upto 1938-39 was declared.

The declaration of this moratorium meant that the general finances could now obtain all the advantages of the General Convention, including the surplus clauses. But even in 1939-40, the surpluses were not sufficient to pay the one per cent. charge, an

arrears of Rs. 30 lakhs remained. The year 1940-41 was more propitious. Taking the immediate needs of the general revenue into account, in that year in addition to the usual provisions an advance contribution of the payment of the portion of commercial surplus realised in 1940-41 which would normally have been paid in 1942-43 was made. Besides, 50 per cent. more of the surplus going to the share of the railways, after these deductions were made, was given to the General Revenues, outside the terms of the Convention. In the year 1941-42 the same arrangements were continued. The Government of India, however in view of the fact that technically speaking, there was no surplus till the past arrears were paid off decided to treat all payments made by railways to general revenues in excess of the one per cent. contribution as paying back of past arrears to general revenues. In the year 1942, the moratorium was extended for one year and similar arrangements continued. But results better than anticipated in the revised estimates for 1941-42 made it possible to wipe out the past arrears and still leave a surplus. Out of this surplus, in 1942-43 an extra sum of Rs. 236 crores was provided outside the Convention so as to enable the general revenues to get the same advantage as provided in the Budget.

For the year 1943-44 the appearance of the Convention could not be kept up. Now no arrears to General Revenues having been left, the continuance of the Convention would have given the General Revenues only a small sum. The Convention has therefore, been scrapped and instead a fresh arrangement whereby the railway surplus profits are to be allocated according to the relative needs of the railways and the Exchequer has been devised.¹ For the year 1943-44 this has been estimated at 1 3 4ths of the estimated railway surplus going to the General Revenues. On this basis the General Revenues are expected to get Rs. 27 crores in 1943-44. Thus the needs of war finance have been responsible for putting an end to the Railway Convention, whose chief object was to ensure the commercial character of railway finance and the pursuit of schemes for the improvement and re-

1. "Till a new Convention is adopted, the distribution of each year's surplus will be decided *ad hoc* after duly weighing the respective needs of general revenues and railways." Railway Budget Speech, para 17

habilitation of railways without interfering with the General Budget, and independently of it. The way in which the railways are now worked will leave large room for repairs, renewals, or replacements in the entire railway property, not to talk of extensions¹. It may be that the railways may find themselves at the mercy of the general financial position in the post-war period. By this arrangement, the Finance Member has succeeded in reducing the deficit to the extent of the railway contribution, but this has been achieved by the sacrifice of the future financial position of the railways which has been made once again precarious as before 1924. The budget speeches of the Railway Member and now of the War Transport Member show full consciousness of the fact. They have frequently laid emphasis on the duty of the Government to be generous to railways in future in view of the services that they perform now. The capacity of the Government to be generous will be governed by the state of post-war finances, when tax-revenues will fall, and new expenditure for reconstruction will have to be undertaken. If this period is accompanied by depression, as is not unlikely, the difficulties will be great.

(2) POSTS AND TELEGRAPHS

The expansion of trade and industry, which the war has brought about along with the greater interest in news, has meant an increasing use of the Post and Telegraph and Telephone services. Coupled with this the Government has increased the prices of these services in almost every Budget after the War. In the 1940 Supplementary Budget changes in rates increasing the receipts of these departments by about Rs. 1 crore were made. The postage for inland envelopes was increased from one anna to $1\frac{1}{4}$ annas, of letters to Burma from $1\frac{1}{2}$ annas to 2 annas, and of Empire letters from $2\frac{1}{2}$ annas to $3\frac{1}{2}$ annas. The minimum on book-post was raised from 6 pies to 9 pies. On ordinary inland telegrams, a surcharge of 1 anna was levied, and of 2 annas on express telegrams. Trunk telephone charges were raised by 10 per cent. In the 1942-43 Budget, further increases were announced. The charge for inland envelopes was raised to

1 The Depreciation Fund of Rs. 84 crores and subsequent additions, if any, will not suffice for the amount of expenditure which will be necessary to put the railways on a sound footing.

1½ annas, the minimum rates for ordinary telegrams were further raised from 10 annas to 12 annas, and for express telegrams from Ra. 1-4-0 to Ra. 1-8-0. The telephone rentals were increased and the surcharge on trunk calls was raised from 10 per cent. to 20 per cent. These increases were expected to bring another crore of rupees. In the 1943-44 Budget the rate for inland letters for each tola after the first was increased to one anna instead of the previous half anna. The inland parcels charge for the first 40 tolas was raised to 6 annas from 4 annas, and the surcharge on telephone rentals was raised to 1/3rd from 1/6th. These increases are expected to produce Ra. 120 lakhs during 1943-44.

The result of these tax measures, along with the war increase in traffic and the acquisition of the telephone systems of Bombay Madras and Calcutta is expected to bring the net profits from the Posts and Telegraphs Department to Ra. 8-3 crores in 1943-44 compared with Ra. 20 lakhs in 1938-39.

The Convention, governing the relations of the Post and Telegraph Department with the Government immediately before the war was that while the Posts and Telegraphs Department was a separate entity which should pay nothing to General Revenues and receive nothing from it, for mutual convenience the balances of the Department or its losses were shown as a part of the General Revenues. The Government had to pay interest to the Posts and Telegraphs Department for the surpluses that remained with them, and vice versa. The present prosperity of the Department however is due to the increased traffic that war has brought about, and also to the increased rates that have been levied. A change in the Convention has therefore been made by which the Government receives the increase in receipts due to additional rates. The remaining receipts are treated as a balance of the Posts and Telegraphs Department but no interest is to be paid on it.

(3) CURRENCY AND MINT

The receipts from Currency and Mint have also been increased by the war. From Ra. 6 lakhs in 1938-39 the revenues have increased to Ra. 5-1 crores. This increase is mainly due to (1) a more profitable working of the Reserve Bank. According to the Reserve Bank of India Act, 1934, the lion's share of these profits goes to the General Revenues, the shareholders getting no

benefit, till the surplus profits reach Rs 4 crores Even after the profits exceed this limit, only a small fraction goes to the shareholders¹ The profits of the Government from this source increased from Rs 20 lakhs in 1938-39 to Rs 320 lakhs in 1942-43 (2) Owing to the increased demand in India for small coins, the profits from minting the small coins have gone up However, in order that the profits from this source might be evened out over a series of years, the Government have decided to take to the receipts account only a small amount fixed at Rs 45 lakhs for 1941-42 This was increased by the addition of the actual expenditure incurred in minting for the subsequent years, the rest is taken to a Suspense Account According to this decision, Rs 15 crores were credited to the Revenue Accounts in 1942-43 compared to Rs 42 lakhs in 1938-39 In 1943-44, the credits will be slightly lower—Rs 13 crores (3) The receipts from other items have also gone up from Rs 20 lakhs in 1938-39 to nearly Rs 71 lakhs in 1942-43 mainly on account of Currency Note Press Profits and fees on coinage for foreign governments The 1943-44 Budget estimates are slightly lower—Rs 38½ lakhs

(4) TAX ON COMMUNICATIONS

The contribution made by the Commercial Departments to the General Revenues during the war period is shown in the following table —

(In lakhs of Rupees)

Year	Railways	Posts & Tele- graphs etc	Total
1938-39	1,37		1,37
1939-40	4,33	..	4,33
1940-41	12,16	33	12,49
1941-42	20,17	1,00	21,17
1942-43 (R. E.)	20,13	2,00	22,13
1943-44 (B E.)	27,10	3,20	30,30

1. The Reserve Bank Act has been recently changed by an Ordinance limiting the dividend of shareholders to 4 per cent

It is obvious that the Government utilises its monopoly in these departments to raise more revenue than is necessary to maintain these services. To this extent the state is levying an indirect tax on the people who are using these services. This is true of Railways and Posts and Telegraphs, but not of Currency and Mint in which case the profits are not in the nature of a tax, but arise because of the peculiar nature of the work, and may be treated as a sort of business revenue for the Government. It is therefore that the revenue from this source is not included in the above table, which shows the amount of indirect tax on communications which is raised by the Government. In considering the structure of taxation in the Central Government, this must be taken into account, and the provisional calculation made above must stand as under after taking into account this tax on communications.

In lakhs of Rupees (Percentage in Brackets)

Year	Business Tax	Direct Taxes	Indirect Taxes including Communications	Total
1933-39	2.04 (2.7%)	13.74 (18.3%)	59.17 (79.0%)	74.95
(B. E.) 1943-44	42.80 (23.0%)	47.10 (25.3%)	96.90 (51.7%)	186.20

It is obvious that the structure of taxation after the war will depend on the extent to which the different types of war taxation are retained. Though the exact nature of the changes cannot be foreseen some of the factors which will operate on the structure of taxation may be indicated. Customs revenue is likely to increase with the restoration of normal trade. Taxes on Income may show a decrease as war profits will disappear. The receipts from the Commercial Services will also go down when war activities cease, and therefore their contribution to the general revenue must decrease. It will be up to the Government of the future to see that its policy is so directed that in spite of the operation of such factors, there is a greater balance as between different classes of people so far as the burden of taxation is concerned.

APPENDIX I

RATES OF INCOME TAX IN 1943-44

(In Pies per Rupee)(a) *Where the total income does not exceed Rs 2000*

	Rate per rupee
1 On the first Rs 750 of total income	Nil
2 On the next Rs 1250 of total income	6

Provided that no tax shall be payable on a total income, which does not exceed Rs 1500

(b) *Where the total income exceeds Rs 2000*

	Basic rate	Surcharge	Total
1 On the First Rs 1500 of total income		Nil	
2 On the next Rs 3500 of total income (1500-5000)	9	6	15
3 On the next Rs 5000 of total income (5,000-10,000)	15	10	25
4 On the next of Rs 5,000 of total income (10,000-15,000)	24	16	40
5 On the balance of total income	30	20	50

RATES OF SUPER TAX IN 1943-44

(In Pies per Rupee)

	Basic Rate	Surcharge	Total
1 On the first of Rs. 25,000 of total income		Nil	
2 On the next Rs 10,000 of total income (25,000-35,000)	12	12	24
3 On the next Rs. 20,000 of total income (35,000-55,000)	24	18	42
4 On the next Rs 70,000 of total income (55,000-1,25,000)	36	24	60
5 On the next Rs. 75,000 of total income (125,000-200,000)	48	30	78
6 On the next Rs. 150,000 of total income (200,000-350,000)	60	36	96
7 On the next Rs 150,000 of total income (350,000-500,000)	72	42	114
8 On the next balance of total income	84	42	126

APPENDIX II

PERCENTAGE TO BE PAID BY WAY OF INCOME AND SUPER TAXES IN 1943-44 IN INDIA.

Income in Rs.	Percentage at Basic Rate	Percentage with Surcharge	Post-Taxed Income in Rs.
3,000	2.3	3.9	2,882
5,000	3.3	5.5	4,726
10,000	5.6	9.2	9,075
15,000	7.9	13.1	13,033
30,000	12.8	21.7	23,503
50,000	18.3	31.2	34,388
80,000	23.9	40.4	47,669
1,00,000	26.0	43.8	56,211
1,50,000	29.8	49.9	75,221
3,00,000	37.3	61.4	1,15,846
5,00,000	43.0	69.1	1,54,388
10,00,000	51.2	80.4	1,96,065
20,00,000	55.3	86.0	2,79,388
30,00,000	56.6	87.9	3,62,721

INCOME AND SUPER TAXES IN U. K. IN 1942-43

Income in £	Tax paid by Married person with three children in £ s d	Percentage paid in tax
120 (Rs. 1,600)		
300 (Rs. 4,000)		
400 (Rs. 5,333)	22 15 0	5.7
500 (Rs. 6,666)	52 0 0	10.4
800 (Rs. 10,666)	186 2 6	23.3
1,000 (Rs. 13,333)	276 2 6	27.6
2,000 (Rs. 26,666)	751 2 6	37.6
5,000 (Rs. 66,666)	2,732 7 6	54.4
10,000 (Rs. 1,33,333)	6,757 7 6	67.6
50,000 (Rs. 6,66,666)	45,319 17 6	90.6

1. Includes post-war credits, Cf. Economist, 11-4-42.

III

PUBLIC DEBT

(1) CLASSIFICATION OF DEBT

At the outbreak of the war, the position of the public debt of India may be described as under .—

(Figures in Crores of Rupees)

Productive Debt	Ordinary Debt	Total Debt ¹ (Including Deposits)
946 38	229 08	1205 76
Interest on Productive Debt	Interest on Ordinary Debt	Total Interest
34 62	11 12	45 74
Rupee Debt	Sterling Debt	Total Debt
736 64	469 12	1205 76
Interest on Rupee Debt	Interest on Sterling Debt	Total Interest
29 12	16 62	45 74

The greater portion of the debt was productive, that is represented capital assets such as railways, posts and telegraphs. These assets paid their own interest charges. This figure also included loans to Provincial Governments which in most cases were used for productive purposes, and the interest on the same is

¹ The total debt includes cash and securities held on Treasury Accounts which was Rs. 30.3 crores in 1938-39

recovered from these governments. The burden to the tax payer on the remaining debt is indicated by the interest charges on Ordinary debt and the annual provision for sinking fund which was Rs. 3 crores at the time. Part of the debt was in rupees and part in sterling. The interest on sterling debt involved a remittance to the U. K. of Rs. 16.62 crores before the war. This obligation was as a rule met by an excess of exports.

(2) DEFICITS

We have seen the increase in expenditure due to the war and considered the efforts made to raise more revenue by taxation as well as by increasing the rates on commercial services which as we have seen is a form of indirect taxation. It was however not possible to meet the increasing expenditure only from taxation, and therefore the budgets of the Government of India resulted in deficits, as indicated below —

Year	Deficit in Crores of Rs.
1940-41	6.5
1941-42	12.7
1942-43	94.7
1943-44 (B. E.)	40.2

The budget for 1939-40 was balanced, but the increasing volume of deficits is evident in the above table. Though the expected deficit for 1943-44 is smaller than that of 1942-43 no one can be sure of the actual results at the end of the year.

Taking the position up to 1942-43 into account, we find that the total war deficits amount to Rs. 113.9 crores including the provision for avoidance or reduction of debt amounting to Rs. 12 crores. Besides this, Rs. 59 crores had to be advanced to commercial departments, which however are expected to earn their own interest charges. The new Capital Defence account required Rs. 49 crores during 1942-43. In all therefore, the Government of India had to obtain Rs. 210 crores from sources other than revenue. This was financed by an increase in regular interest bearing obligations of Rs. 88 crores from sales of silver amounting to Rs. 57 crores and the rest from net balances resulting from other debt head transactions. We shall now consider the loans raised by the Government of India since the war.

(3) DEFENCE LOANS

As early as June 1940, the borrowing programme of the Government of India was merged in a Defence Savings Movement. Three different types of loans likely to appeal to different types of investors were floated. (1) The three-year interest free Defence Bonds, (2) The six-year Defence Bonds, and (3) The ten-years Defence Savings Certificates. The three-year interest free Defence Bonds were to be paid for in cash, and were available upto any amount over Rs 50. They were issued at par and were to be returned at par three years after the date of issue or at three months' notice, but in no case earlier than a year after the date of issue. To meet emergency cases special provisions were made dispensing with the time and period of the notice. These bonds were in effect a gift of interest to the Government, and would be subscribed only by those who wanted to help the Government in this manner for the war. This was however not likely to evoke any enthusiasm under the prevailing circumstances in the country and the total subscription amounted to only Rs 2.33 crores in 1940-41, Rs 2.68 crores in 1941-42, and Rs 3.04 crores in 1942-43 or a total of Rs 8.05 crores in three years. As this loan bears no interest, it is welcome to the Indian treasury however small its amount compared with the requirements of the Government of India.

The three per cent six year Defence Bonds were to be paid back at Rs 101, the maximum amount that could be held by an individual was fixed at Rs 15,000. Due to its stringent conditions, the insistence on cash payments, the maximum laid down and the general unfavourable war situation, the amount forthcoming was small. By July 1940, therefore, they were closed, the total subscription being 0.71 crores. A second series was issued from 1st August 1940 with slightly more favourable conditions. The subscriptions to this loan could either be in cash or the 1940-43 loans could be offered for conversion, the maximum limit on individual holdings still remained. The public response was much greater. By January 1941 Rs 44.43 crores were received, Rs 30.98 crores being in cash and Rs 13.45 crores by conversion. These Defence Bonds were discontinued on 25th January 1941. In their place, a second 3% Defence Loan, 1949-52 was arranged, the limit on maximum individual holdings

being removed. This loan was available up to 14th February 1942 by which time the war situation, which took an unfavourable turn once again, made the loan unattractive. The total subscription for this loan amounted to Rs. 59.06 crores. In July 1942, a third Defence Loan, which was a reissue of the 3% 1951-54 loans was started and by the end of February 1943 Rs. 45 crores had been subscribed. Subscriptions to the Third Defence Loans have stopped from 1st July 1943. In its place, a Fourth Defence Loan to mature a year later is issued at par. The subscriptions have to be either in cash or in 1943 bonds, the latter tenderable up to 17th July only. At the same time, a longer-term loan with better terms has been issued. The 1963-65 3% loan is reissued at Rs. 95.8-0 a full half year interest is promised by the end of November. Subscriptions were to be received till they reached the sum of Rs. 15 crores (nominal) or on 10th July whichever was earlier. The sum was so fixed as to equal the outstanding amount of the 1943 4% bonds. The subscriptions were closed on 5th July.

(4) DEFENCE LOANS FOR SMALL INVESTORS.

In addition to these Interest Free Bonds and 3% Defence Loans, to encourage small investors the Government of India has from June 1940 issued ten year Defence Savings Certificates in the denominations of Rs. 50 100 and 5000. A maximum of Rs. 5,000 has been laid down. The interest as a whole on this loan amounts to 3½% compound interest free of income tax. But the scheme has not been able to arouse much enthusiasm. From June 1940 to March 1942 it yielded only Rs. 5.22 crores, in spite of the fact that to induce investment in these certificates the Government of India has introduced a rule permitting Local or Municipal Boards, Universities or the governing bodies of Educational Institutions to purchase Defence Savings Certificates out of their employees provident fund account. In 1942-43 only Rs. 1 crore could be attracted. From April 1 1941 with a view to further encouragement a new scheme of Post Office Savings Bank Accounts known as the Indian Post Office Defence Savings Bank was introduced. According to this scheme, the deposits were not to be repayable till one year after the war and the interest was raised to 2½ per cent instead of 1½ per cent. This

could only attract Rs 11 lakhs by March 1942. In the 1942-43 budget, as we shall see later, a further inducement was given to those having an annual income between Rs 1500-2000.

Apart from these loans, the counterparts of sterling debt which was repatriated¹ and taken up by the public, and the conversion of some of the sterling debt into rupee loans the two amounting to Rs 87 crores and the reissue of the 3 per cent 1963-65 loans to pay for capital liabilities of Railway Annuities amounting to Rs 15 crores have meant a further increase in our rupee debt. While the first two meant only, an increase in rupee debt, the last meant an increase in the total debt. The floating of loans by Provinces to repay their debt to the Centre has resulted in a decrease of about Rs 11 crores in the Central Debt on that account and thus made greater amounts available for financing the various requirements.

The total result of all these measures has been that the rupee loans have increased from Rs 437.87 crores to Rs 762.15 crores, that is, by about Rs 325 crores by 1942-43. Adding to these, the new Post Office Savings Schemes, the new certificates and the interest free bonds, the total new loans amount to Rs 340 crores. As against these, however, must be set the fact that the war has witnessed a fall both in the Post Office Cash Certificates and the Post Office Savings Bank Deposits. From Rs 59.57 lakh in 1938-39, the Certificates fell to Rs 57.02 lakhs in 1939-40, to Rs 46.98 lakhs in 1940-41, and in 1941-42 they further declined to Rs 39.19 lakhs. By the end of 1942-43 a decline of Rs 5.00 lakhs was expected, thus in course of 3½ years of war a net encashment of about Rs 25.38 lakhs would have taken place. The Post Office Savings Bank deposits reveal an equally sad tale. From Rs 81.94 crores in 1938-39 they declined to Rs 78.38 crores in 1939-40, and to Rs 59.57 crores in 1940-41. The heavy withdrawals continued in 1941-42 and the Government introduced a rule permitting the depositing in a Post Office Savings Bank of the provident fund moneys of the employees of a private firm or company. But the rule did not check the tendency. By 1941-42, the deposits were only Rs 51.39 lakhs and

1 The problem of repatriation of sterling debt will be discussed later.

by the end of March 1943 were estimated to decline by another Rs. 210 lakhs. The total reduction will thus be Rs. 32,65 lakhs.

(5) SHORT TERM LOANS.

The short-term borrowing of the Government has registered a great increase. The great ease prevailing in the money market has enabled the Government to borrow large sums of money for a short time at a nominal rate of interest. The demand for Treasury Bills even at a meagre rate of interest has been insatiable. The Treasury Bills and the Ways and Means Advances have increased from Rs. 46.3 crores in 1938-39 to Rs. 272.98 crores in 1942-43 that is, by Rs. 227.68 crores. The percentage, these short term borrowings bear to total debt, has increased from 6.5 in 1938-39 to 21.8 in 1942-43.

(6) OTHER FUNDS.

Along with these increases amounting to about Rs. 510 crores, the other funds at the disposal of the Government have also undergone an increase. The State Provident Funds have risen by about Rs. 11 crores and the various Depreciation and Reserve Funds by Rs. 57 crores. With other minor additions and decreases, this has meant that the total obligations in India have increased from Rs. 736.64 crores to Rs. 1312 crores or by about Rs. 575 crores by the end of 1942-43.

(7) REDUCTION IN STEELING DEBT

The fact that the rupee obligations of the Government of India increased by Rs. 575 crores as against the financing of Rs. 210 crores for their budget deficits and capital account up to the end of 1942-43 is explained by another feature of war finance. The Government of India obtained huge sterling resources since the war in two ways. The Reserve Bank has been able to purchase large quantities of sterling due to the fact that we have an unusually large balance of trade in our favour. At the same time, the Government of India as we have seen above provides the rupee finance required for the British and Allied expenditure in India, and receives payment in return in sterling.¹ Part of the

1 More details about the sterling resources obtained in both these ways will be given later

large sterling resources thus accumulated has been used for the repatriation of our sterling debt and other sterling obligations. The sterling debt has in consequence fallen from Rs 469.12 crores in 1938-39 to Rs 93.32 crores in 1942-43, that is, by Rs. 375.80 crores by the end of 1942-43. The sterling debt has been replaced by rupee debt in India as far as possible by the issue of rupee counterparts. Some of these were however cancelled, and Rs 89 crores were held by the Reserve Bank of India. The rupee finance thus raised was used to finance the British and Allied expenditure in India referred to above.

The total interest-bearing obligations of the Government of India have thus increased from Rs 1206 crores to Rs 1405 crores or by about Rs 200 crores by the end of 1942-43. Part of this increase or Rs 60 crores is on account of productive debt, Rs 74 crores are held in cash and securities by the Reserve Bank on Treasury account. The unproductive debt has therefore increased by Rs 66 crores only. Owing to the favourable terms on which new loans have been floated, the gross interest payments have decreased by more than Rs 8 crores, the decrease in net payment being only slightly less.

(8) RECORD ACHIEVED BY EXCLUSION OF MATERIAL FACTS

These figures at first sight present a remarkable achievement. A budgetary deficit of only Rs 100 crores in $3\frac{1}{2}$ years of a totalitarian war, an amount of new rupee loans raised in India sufficient not only to make up this deficit but also to carry out a great part of the desirable repatriation of sterling debt, and these at a rate of interest which has resulted in a reduction in the total interest charges—this record, considered by itself without the other relevant and essential features of war finance in India, is one of which any Government may feel proud. Unfortunately this is only an illusion—a mirage created by the device of excluding material facts of war finance in India from the budgets of the Government of India, in spite of the fact that they have undertaken the responsibility for and are carrying out large financial disbursements on behalf of the British and Allied governments in

1 This is made up by rupee debt of Rs 1312 crs and sterling debt of Rs 93 crs

India. The exact magnitude of these disbursements is not revealed we have to infer the same from indirect evidence. Expenditure incurred for the British Government was casually mentioned in the Budget Speech of 1942-43 as being Rs. 200 crores in 1941-42¹ and more than Rs. 400 crores in 1942-43.² We have no systematic data for each year. As against this we are told that the total sterling payments made by His Majesty's Government to India upto the end of December 1942 amounted to Rs. 505 crores.³ This is the amount recovered from His Majesty's Government. It is quite possible that there was some recoverable expenditure in India which was yet to be paid to India by this time. If we assume that upto the end of the financial year 1942-43, that is for the first three months of 1943 additional expenditure of Rs. 50 crores was incurred for His Majesty's Government in India including the arrears not paid upto December 1942, we may assume the total by 31st March 1943 to be Rs. 555 crores. The total defence expenditure of the Government of India charged to Indian revenues since 1939-40 amounted to Rs. 553 crores by the same date. In other words the Government of India spent as much on behalf of the British Government as on their own account upto the end of 1942-43.

The financing of these huge amounts of expenditure, if properly shown in the budgets of the Government of India, would have revealed the unpalatable truth that they were carrying on with deficit financing to this extent with only part of the requirements met from loans, and therefore by inflation of currency. We have made these estimates upto the end of 1942-43. For the year 1943-44 the estimated expenditure charged to India for defence is Rs. 200 crores including capital account. We do not know the amount which the Government of India will provide in rupees for the British Government during 1943-44. We find however that out of the Rs. 505 crores worth of sterling paid to India upto the end of December 1942, Rs. 196 crores were paid upto January 1942. In other words during the eleven months from February to December 1942, the amount of sterling paid was Rs. 309 crores. If we take this as the indication of expendi-

1. Budget Speech, para 17

2. *Ibid*, para 25.

3. Explanatory memorandum to the Budget for 1943-44, p. 46.

ture which India incurs on behalf of His Majesty's Government in recent times, we may assume that in the year 1943-44, it will be about Rs. 300 crores, and under certain conditions it may be much more¹ There is no provision in the budget for this large uncertain amount to be financed, we may assume that it will be financed by inflation of currency

(9) RUPEE FINANCE FOR U K BY LOANS

We do not propose to discuss the problem of inflation at this stage. Our main concern here is to see whether it was not possible to raise these additional amounts for which the Government of India have rightly or wrongly assumed responsibility, from the existing sources of the people, that is by taxation or loans. We have already discussed the difficulties of additional taxation and pointed out that the scope for further taxation, if at all, is on those few rich persons whose incomes increase under present conditions and to which a ceiling may be put. On principle, it is better to finance a war as far as possible from taxation. But modern wars are so costly that no country can raise the necessary amounts by taxes. Loans have therefore to be raised to supplement the resources obtained from taxes. Whereas the relative position of taxes and loans must have significance so far as the financing of the expenditure charged to India is concerned, that problem need not arise in the case of the financing of the expenditure in India charged to the U K and the allies. The resources required for this latter purpose may be raised by loans without burdening the future generations, as the amount should in effect be a rupee loan to the U.K. and the principal and the

1 The recent meeting between Mr Churchill and President Roosevelt at Washington in the latter part of May soon after the African campaign was over, which Field Marshall Wavell and other Eastern Commanders were invited to attend indicates the possibility of increased military activity in the East and on the Indo-Burma frontier. As the base of operations for these activities will be India, the increased expenditure on that account, irrespective of its allocation, will be incurred in rupees in the first instance. The estimate of Rs 300 crores for the year 1943-44 made on the basis of similar expenditure of the preceding year may in consequence be exceeded considerably, thus requiring still more rupee finance of uncertain magnitude

Interest must in due course be received from the U.K.¹

(10) LOAN POLICY OF THE GOVERNMENT OF INDIA.

So far as loans raised in India are concerned, in the first place we must note the fact that there are large idle monetary resources in the country at present seeking investment but not able to find suitable avenues. The figures of deposits of scheduled banks are an eloquent testimony to this fact.² At the same time we have witnessed a feverish activity in the capital market in the country during recent months for the floatation of new companies, mainly banking and insurance, with large capital. This is accompanied by the tendency of some existing companies to increase their capital. That private investment of such magnitude should be possible in concerns all of which cannot be considered as sound, at a time when the Government of India are in dire need of funds, is the greatest paradox of war finance in India.

In order to profit by the experience of other countries during the present war we may at this stage briefly review the methods adopted by them to finance the unparalleled expenditure of the present war from the existing resources of the people, that is, by taxes and loans. We are concerned with loans in the present context. It is well known that so far as loans are concerned what is known as the cheap money policy has been adopted in the U.K. and the U. S. A. This war has in consequence been called a three per cent. war.

(11) VOLUNTARY SAVINGS IN OTHER COUNTRIES.

The special concessions which were formerly given to induce investment in loans, namely *issue of a loan at a discount or free of income-tax* are no longer given. The payment of a higher rate of interest or giving such other concessions may induce a greater preference for the future in the minds of those who have savings to invest. But this would involve a greater burden on posterity a greater transfer in future from the poor to the rich, and from the enterprising and energetic section of the people to the leisure class. In spite of the absence of such inducements, other countries have succeeded in raising more loans by the adop-

1. A fuller discussion of this problem will be found in chapter V

2. Details of this will be given in the next chapter

tion of several special measures. The conscription of labour and capital in some countries has enabled them to restrict the production of wartime superfluities. The same object is achieved by the rigid control of imports. The comprehensive price control and well-conducted rationing schemes that most of the belligerent countries have adopted reduce the scope of individual expenditure and compel the people to save. The 'price ceiling' system in the U.S.A., in Canada and in Australia, whereby the prices of any commodity, wages and rent could not be higher than those prevailing on a fixed date is the most thorough effort to restrict private expenditure. Several countries have also adopted the device of limiting dividends, so as to diminish individual incomes. In some countries, no new investments can be floated without the sanction of the Government. This sanction is refused except in the case of war industries. The object of this is to divert the savings of the people to government loans. The control over imports, and the difficulties of replacing goods and machinery, most of which cannot be had except for priority certificates, have also resulted in a diversion of investment to government loans¹. Besides vigorous appeals to patriotism, occasional Savings Weeks, and various Savings Movements have contributed to increased savings and larger contributions to government loans, which have averaged £30 million a week since the outbreak of the war in the U.K.

(12) COMPULSORY SAVINGS IN U.K.

It was felt that the savings induced by the above methods may not suffice, and if that happened inflation would have to be faced. To prevent this contingency, Keynes advocated a Compulsory Savings Plan, by means of which everyone earning above a certain sum would be required to put aside a certain percentage of his income as savings, which would be returned to him only after the war. The British Government, while not accepting the Keynes Plan in detail, have introduced two measures of compulsory savings, which embody the principles of the Keynes Plan.

1 The British White Paper estimates the disinvestment in England (excluding disinvestment abroad) at £286 million in 1940, and £493 million in 1941. In Germany in 1940 about 12,000 million marks were disinvested.

The Excess Profits Tax was levied in England at the rate of 100%. As a result of great agitation it was reduced to 80% in April 1941 with the provision that the assessee would continue to pay 100% but that 20% would be returned after the war. In the budget for 1941-42 the taxable minimum in the U.K. was lowered to £. 100 bringing 2 million more persons under the income-tax. The tax thus obtained is credited to the account of the assessee to be returned after the war. From this source alone, a sum of £. 125 million a year was expected.

(13) VOLUNTARY SAVINGS IN INDIA.

Attempts have been made in India to induce savings on similar lines on a limited scale. In the case of Income Tax assesses, a scheme was made to induce voluntary savings in the budget for 1942-43. Those with incomes between Rs. 1500 and Rs. 2000 were made liable to the tax at 6 pfa in the rupee. The assessee had however the option to pay into a separate account with the Post Office Savings Bank one rupee for every Rs. 25 by which his income exceeded Rs. 750 that is, about $1\frac{1}{2}$ times the amount of tax he would otherwise be charged. The deposit earns interest at the rate of $2\frac{1}{2}$ per cent. and cannot ordinarily be withdrawn till one year after the war. The amount thus deposited is not published, but it cannot be large.

In the budget for 1942-43 a provision was made by which if an assessee to the E.P.T. deposited with the Government a sum in excess of the tax, the Government would contribute an amount equal to half the sum so deposited, but not greater than one tenth of the net E.P.T. With the E.P.T. rate at $66\frac{2}{3}$ per cent. the maximum deposit that an assessee would thus contribute was $13\frac{1}{3}$ per cent. of his excess profits, the Government contribution being half of this or $6\frac{2}{3}$ per cent. Interest at the rate of 2 per cent. is allowed on the assessee's contribution which will be returned a year after the war. The Government contribution is payable after the war according to the conditions and the time to be determined by Government.

The principle of this provision is sound, but the conditions under which it was made were not likely to evoke a good response. If the very desirable objects which it was sought to achieve were to be fulfilled, the arrangements ought to have been

such as would induce industrialists to take the fullest advantage of the scheme. The Excess Profits Tax has yielded handsome results, namely, Rs 26 crores in 1942-43, and is expected to yield Rs 40 crores in 1943-44, though some eminent businessmen expressed the view at the time of the last budget that these were large arrears and that these figures were underestimates¹. The limited success of this measure can be seen from the fact that only Rs 2 crores were deposited by the assesseees during 1942-43; for 1943-44 Rs 4 crores were expected in the budget estimates.

(14) COMPULSORY SAVINGS IN INDIA

It was provided in the budget for 1942-43 that in the case of persons whose incomes did not exceed Rs 6000, an amount equal to $\frac{1}{2}$ per cent of the assessee's total income should be funded for his benefit and repaid to him after the war. His tax would be reduced by this amount. This was at once a small relief and a compulsory loan. The exact amount thus collected is not published, but it cannot be large.

By an Ordinance issued in May 1943 regarding certain changes in the E.P.T., the system of optional deposit referred to above is made compulsory. At present besides the E.P.T. at $66\frac{2}{3}$ per cent. the assessee pays another $13\frac{1}{3}$ per cent by way of income-tax and super-tax, which means that the State taxes 80 per cent of the excess profits. Out of the remaining 20 per cent the assessee will now be required to make a deposit of $13\frac{1}{3}$ per cent, leaving $6\frac{2}{3}$ per cent. for distribution as dividends or for other purposes. The Government of India will however contribute $6\frac{2}{3}$ per cent. to this deposit which will thus amount to 20 per cent. The assessee will get an interest of 2 per cent. on his own contribution, which he will be allowed to withdraw within a year after the war or two years from the date of payment whichever is later. The Government contribution will be paid within three years of the end of the war or earlier if the assessee

1 This was admitted within less than two months of the passing of the budget for 1943-44 by the Finance Member in connection with the Ordinance issued in May by which summary assessment for the collection of EPT has been provided. He estimated the arrears to be about Rs 100 crores. This will be discussed later.

is able to show that he wants to use it advantageously at an earlier date.

Whereas the Government contribution in the Voluntary scheme had some justification, it is difficult to justify this contribution in the compulsory scheme. Its only effect is to reduce the EPT by $6\frac{1}{2}$ per cent. At the same time, it is not easy to understand why the Finance Member did not follow the logical step of his new policy by taking the entire 20 per cent. of the balance of excess profits as a compulsory loan and has still left $6\frac{1}{2}$ per cent. untouched. In view of the fact that the Excess Profits Tax payers were allowed large concessions for the last three years, this solicitude for them is hard to explain.

(15) SUGGESTIONS FOR RAISING MORE LOANS.

We have seen that the efforts of the Government of India to raise an adequate quantity of money by loans have not succeeded so far. It is desirable therefore to consider more thorough going and even compulsory methods by which the war can be financed on sound lines and inflation prevented. We shall refer in brief to some of the measures which may be explored in this connection with advantage. Each of these may have its difficulties, and though adequate steps to meet them will be necessary the fact of difficulties should not be an argument against their application under the present circumstances. (a) It is possible to have a scheme for linking up the declaration of dividends by companies with investment of a portion of profits in Government loans on the lines suggested by Sir Vithal Chandavarkar in the Assembly during the discussion on the Finance Bill for 1943-44. (b) It is also possible to make the compulsory scheme of savings in the case of Excess Profits Tax payers applicable to the remaining $6\frac{1}{2}$ per cent. of the profits as suggested above. (c) Employers can be asked to make the payment of a part of cash bonuses in War Savings Accounts. This does not mean any limitation on the total benefits that the workers may legitimately be entitled to under the present conditions. This will merely be a scheme of deferred payments which will give substantial advantages to the workers in the post war period, as against the use of their extra resources at present under conditions of high prices. (d) In the case of Government employees whose salaries

exceed Rs 6000 per year, there should be a scheme of compulsory savings, which should be at a progressively higher rate in the case of larger incomes. In view of the high salaries at which Government has been recruiting large numbers of people for its various war departments, it is setting a bad example to private employers and is adding to the inflationary tendency. Either the salaries should be reduced to more reasonable levels or if that is not possible because of existing commitments, a good slice should be diverted to war loans by compulsory savings. Those below Rs 6000 a year already come within such a scheme and hence the suggestion made above is for those above this figure. (e) Once the Government of India adopts such a scheme for its employees, it can ask the Provincial Governments, semi-government bodies and private employers to do the same.

(16) REGULATION OF PRIVATE INVESTMENT

(f) At the same time there should be effective regulation of private investment during war time. This should be confined as far as possible to immediate essential needs for industrial production. So long as this is not done, and speculative private ventures of all sorts are allowed to be floated, which raise hopes in the minds of investors of high dividends, it is impossible to expect them to subscribe to 3 per cent Government loans. Such regulation will on the one hand divert some of the savings to war loans, and on the other prevent many investors from falling victims to some of the mushroom companies which are now being floated every week.

In this connection, the recent step taken by a new Defence of India Rule (No 94) by which the floatation of new companies as well as schemes of reconstruction or recapitalisation of existing companies have to be approved by the Finance Department is a step in the right direction. The object is to prevent the growth of mushroom companies or practices of over capitalisation which may lead to trouble after the war. Those who desire to undertake sound industrial development or expansion calculated to help the war effort will not have any difficulty in getting the necessary sanction. Such a provision as pointed out above was long overdue. If it had been made in time, the recent floatations which have diverted private investment of crores of rupees to themselves

would not have taken place. By this restriction the channels of investment will be narrowed and the inducement to invest in war loans will be provided thus putting an end to the existing paradox of war finance in the country a situation in which huge private investment was going on at a time when the Government of India was badly in need of funds to obtain which it had to resort to the printing press.¹

(g) Along with such schemes there should be effective arrangements for price-control of a comprehensive nature on a country wide basis.²

(17) CO-OPERATION OF THE PEOPLE FOR INTERFERENCE IN THEIR ECONOMIC LIFE

The object of the various schemes referred to above is to divert surplus purchasing power from the hands of the public to the Government in the form of loans, thus limiting private demand on the diminished quantity of goods available for civil consumption, and at the same time enabling the Government to do without artificial purchasing power or inflation. This twofold effect is sure to have a healthy reaction on prices, if such measures are applied in time and in a comprehensive manner.

These remarks are made with a view to point out that it was possible and is still possible to provide the rupee finance required for the British and the allied governments by well thought out schemes of savings, voluntary or compulsory as well as of control of prices, which should be sufficiently comprehensive in its outlook, completely co-ordinated in its working and above all inspire the confidence of the people. It must be admitted that the Government of India as at present constituted do not inspire this confidence, and measures of control in the economic life of a people by an unpopular government are bound to be resented and even opposed or defeated in practice by withdrawal of co-operation, which is essential for their success. We have already seen how the small investors in Post Office Savings Banks and

1. It may be pointed out that the Finance Department is not following the point of view expressed above inasmuch as it has recently sanctioned the floatation of new companies which could have been postponed.

2. This will be discussed in greater detail in Ch. V

Savings Certificates have withdrawn large amounts at a time when Government need these funds most. This may be partly due to the pressure of rising prices which may have compelled some persons to live on their savings, but partly it must also be due to a lack of confidence in the Government. In other words, if the people of the country are made to feel that this war is as much theirs as that of the British and the allies, that it is surely going to lead to their independence from foreign rule, and that in the conduct of the affairs of state during war-time they have adequate control through their chosen representatives, it should be quite easy to win the necessary confidence of the people to put up cheerfully with the various controls in their economic life by full co-operation in their working, and at the same time to give whatever they can by way of loans to help the financing of the war without inflation. Instead of this very desirable confidence of the people in the war effort, we have unfortunately a serious and prolonged political tension which makes the people not only apathetic towards the war effort but leads them in a spirit of frustration and desperation to evade measures of control and defeat them if possible in practice. This tragic state of affairs is enhanced by the fact that instead of financing the British and allied requirements by loans, the policy of inflation has been adopted with its inevitable consequences on the economic life of the people. The people see the fact of daily rising prices and feel their suffering in consequence and naturally attribute all this to the policy of the Government, the only supporters of the Government being those few rich persons, who as contractors of Government in one form or another, are able to reap a rich harvest out of the war, irrespective of their political leanings.

Thus the solution of the political deadlock in the country is closely bound up with the solution of the economic and financial policy of the country during war time. If the former is allowed to deteriorate further, we may have to face still greater difficulties in the financial and economic sphere because of reasons which will be discussed in the following chapters.

IV CAUSES OF INFLATION

(1) DEFINITION OF INFLATION

Inflation may be defined as a state of affairs when the volume of currency goes on increasing without being accompanied by a corresponding increase in production. The total quantity of money thus increased does the work of media of exchange for a relatively smaller quantity of goods and therefore prices will rise or the value of the monetary unit will fall. When this tendency is observed over some period of time, and when the causes leading to it continue in operation, inflation may assume dangerous proportions. That inflation started in India some time ago and that by now it has reached serious proportions cannot be denied. The note circulation increased more than three times from Rs. 179 crores in August 1939 to Rs. 644 crores by the end of March 1943. By no stretch of imagination can we say that production has increased in the same proportion. Prices have increased and are still increasing further. The value of the rupee has fallen and will still fall further with the continuation of this policy.

Sir James Taylor in his speech at the Annual Meeting of the Reserve Bank of India in August 1942, admitted that there was a considerable rise in prices in India. He opined, however, that there was no cause and effect between the increase in the currency and the rise in prices. He tried to argue that both these phenomena were the unavoidable result of the large purchases of goods and services being made by the British Government in India for which they give us sterling which we exchange for rupees. He assumed that the payment to us in sterling was natural and therefore the increase in rupees was not avoidable. He further observed that unless this increase in purchasing power can be met

by an equal increase in the supply' of goods, 'there is bound to be an increase in commodity prices in this country' This is exactly the definition of inflation, the existence of which he tried to explain away And as production has not increased and could not increase at the same speed as currency, the fact of inflation cannot be ignored by such fallacies

(2) INCREASE IN NOTE CIRCULATION

The effect of war finance on the monetary situation in the country may now be examined There has been a large increase in the Notes issued by the Reserve Bank mainly against the addition of sterling securities to the reserve in London¹ This is indicated by the following figures —

(Figures in crores of Rs.)

	Total Notes Issued	Notes in Circulation	Sterling securities in the reserve
August 1939	216.78	178.89	59.50
Average 1939-40	227.75	208.86	78.32
Average 1940-41	258.77	241.62	129.97
Average 1941-42	320.63	308.46	165.44
On 26th March 1943	655.11	643.58	421.71
Increase ¹	438.33	464.69	362.21

Thus the Notes in circulation have increased by 260 per cent. and this has been possible mainly on account of the increase in sterling securities in the reserve. Before discussing the nature of this reserve, we shall consider the total monetary position We

1 The rest of the increase in the note issue is covered by an excess in Rupee Securities, which also make up for the fall in the Rupee coin in the reserve Part of the rupee securities are *ad hoc* securities of the Government of India or Treasury Bills issued to the Issue Department of the Reserve Bank against which notes are issued. Rupee Securities increased from Rs. 37 crores in 1939-40 to Rs. 174 crores on 26th March 1943 The significance of this will be pointed out later

should also have to take into account the change in metallic circulation. But it is difficult to estimate this with any degree of precision. More than 104 crores of rupees or one rupee notes have been issued since the war after allowing for old standard rupees which have been returned to the bank. Some rupees must have been hoarded and of this no estimate is possible. If we add this to the figure of increase in note circulation we have Rs. 569 crores as the increase in currency since the war upto the end of 1942-43.¹

(3) DEPOSIT MONEY

Deposit money which is another form of money largely in use in advanced countries, though not of as much importance in India as elsewhere, was gradually coming into its own, particularly since the inception of the Reserve Bank. We find however that this form of money has gone down in volume instead of rising as may be expected under similar circumstances

1. The increase in note circulation since the beginning of April 1943 is shown below —

(In crores of Rupees)

Date	Total Notes Issued	Notes in Circulation	Sterling Securities In Reserve
2nd April	660.70	651.38	447.66
9th "	671.97	663.20	467.64
16th "	681.16	669.38	493.59
23rd "	683.89	673.43	493.59
30th "	689.79	677.61	501.49
7th May	700.13	689.71	515.49
14th "	706.99	696.15	523.49
21st "	712.47	700.61	529.49
28th "	715.23	704.11	532.49
4th June	724.28	713.05	542.49
11th "	732.83	721.66	552.49
18th "	734.45	722.94	554.49
25th "	734.75	723.35	564.49
2nd July	746.15	733.61	567.79
9th "	748.26	737.62	570.79

in other countries. The following figures are significant in this connection

Scheduled Banks.

(Figures in Crores of Rs)

	Demand Liabilities	Time Liabilities	Percentage of advances and discounts to liabilities	Percentage of cash and balance with Reserve Bank to liabilities
1939-40	140	106	53	10.0
1940-41	164	105	47	16.6
1941-42	202	104	40	14.8
Oct. 1942	322	102	19	18.4
Nov. 1942	332	105	19	17.5
Dec. 1942	340	110	21	15.0
Jan. 1943	345	114	22.5	13.9
Feb. 1943	360	118	23.8	13.3
Mar. 1943 ¹	372	121	26.1	13.4

Whereas in 1939-40, 53 per cent of the liabilities of scheduled banks was due to advances and discounts, now this has fallen to only 26.1 per cent. The banks, therefore, have definitely reduced this form of money which it is in their power to create. This power, however, cannot be exercised unless there is a demand from the public for loans from banks. It follows, therefore, that the commercial community is not in a position to undertake business activity on a large scale from borrowed funds.

(4) IDLE MONETARY RESOURCES

The demand liabilities have, however, been increased from Rs 140 crores to Rs 372 crores, though the time liabilities are almost stationary. The explanation of this rise in spite of the reduction of loans by banks may be found in the fact that some people who have now larger incomes and savings prefer to keep them in this liquid form instead of investing them either in securities or in business. This inference is borne out by the fact that the banks increased their percentage of cash to liabilities from 10 to 13.4 or from Rs 24 crores to Rs 66 crores by March 1943. The banks have to maintain these large liquid re-

1 The corresponding figures for recent months are given below —

April 1943	375	124	27.3	12.2
May 1943	391	126	28.3	13.0

sources to meet any unforeseen demands from their depositors whose deposits have swelled to such an extent in the manner explained above. This means that a large portion of the country's monetary resources is now lying idle in this form not able to find suitable channels of investment.

The remark that these resources are comparatively idle is proved by a glance at the clearing house returns which indicate the velocity of bank deposits in their use as money

Clearing House Returns in Crores of Rs

	Demand Liabilities of scheduled banks.	Clearing House Returns. Total for the year	Velocity
1939-40	140	2,308	17
1940-41	164	2,136	13
1941-42	202	2,700	13
1942-43	372	2,773	7.4

It is obvious that the clearing house returns do not show any increase in proportion to the increase in bank's deposit liabilities, thus showing a big fall in the velocity of this form of money

(5) RECENT TENDENCY TOWARDS GREATER ACTIVITY

It may be pointed out, however that these large idle resources will become active as soon as there is an optimistic turn of events affecting the money market and the business community in general. At such a time not only will the people who own these deposits use them more actively but the banks will also be called upon to give more advances and create more deposit money. The potential capacity of the banks to do so is large in view of their present position. In this connection, it is significant that the percentage of advances and discounts to liabilities of scheduled banks which had fallen to 19 in October 1942 has gradually risen and was 26.1 in March 1943, in spite of the fact that the total liabilities have increased.¹ At

1. The recent figures given in the last footnote show that the tendency continues.

the same time, the percentage of cash to liabilities shows a tendency to fall from 18.4 in October 1942 to 13.4 in March 1943. The recent increase in private investment by the floatation of new companies, particularly banks, must have added to the tendency

(6) RISE IN PRICES

In spite of the fact that this important part of the monetary circulation in a modern country is comparatively dormant in India at the present moment and is, therefore, not exerting a marked influence on the level of prices, we find that prices have risen considerably, particularly during 1942-43, and in the current year. The Calcutta Index Number rose from 115 in 1939-40 to 272 in March 1943.¹ The Bombay Index Number of wholesale prices rose from 109 in 1939-40 to 256 in March 1943. The Index Number of weekly wholesale prices prepared by the office of the Economic Adviser to the Government of India with the prices of the week ending 19th August 1939 as the base, shows a rise from 100 to 220.1 in March 1943.

Every one of us has felt the impact of this sudden and large rise in prices of most commodities, in some cases, we know to our cost that the price that we have to pay is even higher than the index number indicates. This is so particularly in the case of imported articles which have been very scarce. Even in the case of some locally made articles the rise is much above the average and is acutely felt. And the actual price that we pay in most cases is higher than the recorded price, which is the control price usually not in operation.

Though there are known causes of the relative scarcity of many articles of common use, it is not easy to explain the large general increase in prices on that account. Imports of manufactured goods are confined mainly to the commodities required for the war. The cessation of imports of rice from Burma and the exports of certain foodstuffs have led to a most acute situation in regard to the food supply of the country. Besides such tendencies there are problems of scarcity in certain parts of the country due to transport difficulties. We in Bombay depend for

¹ The Calcutta Index Number rose to 293 in April, and to 325 in May 1943.

our food supplies of all sorts on outside sources and it is therefore that we have periods of acute and even prolonged shortage of some essential articles, which cannot be purchased and brought to Bombay in sufficient quantities at the right time.

Though part of the rise in prices in some cases can be accounted for by real scarcity the explanation of the general level of prices of all commodities rising at a rapid rate as witnessed in recent months, is to be found in the existence of an increase in the money supply of the country more than justified by the level of production. It is difficult to estimate the increase in production in the country even in normal times. It is more so under the present conditions. The main difficulty is the paucity of statistical data due to the absence of an adequate machinery to collect the necessary material. Some estimates have, however, been attempted and the increase in production is put at about 20 per cent. since the beginning of the war. The total notes in circulation have, however, increased from Rs. 179 crores in August 1939-40 to Rs. 644 crores on 26th March 1943.¹ This rise of 260 per cent. in the notes in circulation is the most important factor in the financial arrangements of the country during the war. The rise in prices is somewhat lower than this, namely from 115 in 1939-40 to 272 in March 1943 and is partly attributed to real scarcity. On the other hand, part of the increase in the money supply may be neutralised by the increased production, and part by the desire of the people to hold their income and savings in the form of money either in their own possession or in banks, as already explained. Even allowing for these factors, we cannot but conclude that the money supply in the country is much in excess of the demand, that therefore the value of each unit of money has fallen, and prices in general have risen.

(7) RISE IN COST OF LIVING.

This tendency is well brought out in the Cost of Living Index for the working classes prepared by the Labour Office in Bombay

1. It is possible that the monetary supply in the country at the beginning of the war was not adequate for the then requirements. The first increase in the money supply must have had the healthy effect of restoring equilibrium, which was, however, short lived, as the tendency for the money supply to increase became more marked and continuous.

The relevant figures are given below. The tendency in other parts of the country is also similar. The sharp rise in recent months since the beginning of this year is significant.

Cost of Living Index (Bombay)

(July 1933—June 1934 = 100)

1938	106	1942 August	168
1939	106	„ Sep	170
1940	112	„ Oct	172
1941	122	„ Nov	178
1942 Jan	137	„ Dec	188
„ Feb	135	1943 Jan	203
„ March	137	„ Feb	205
„ April	138	„ March	208
„ May	142	„ April	225
„ June	152	„ May	227
„ July	168	„ June	232

(8) VICIOUS SPIRAL OF INFLATIONARY PRICES

Some people have argued that the rise in prices is due to scarcity and not to inflation. Others have coined the phrase 'price inflation' which they assert exists irrespective of 'money inflation'. In order to have a clear idea of what exactly is happening we have first to distinguish between expansion of currency which arises because of a genuine public demand, and expansion of currency which takes place because the government of a country finances itself by putting itself in possession of purchasing power by this method and then obtains goods and services from the public in exchange for the same. The former is expansion of currency; the latter is inflation. The former is the genuine use of currency in the interest of the public, the latter is the desperate misuse of currency not in the interest of the public, but the last resort of a government which is not able to obtain funds by legitimate methods.

Let us now consider as to what happens when such purchasing power is used by government. The government purchases goods and services, let us say this week with the help of new notes, say of Rs 5 crores which are thus pushed into circulation. It creates a gap in the existing stock of goods, which therefore become scarce to that extent, unless an equal additional quantity

can be produced in the interval. The scarcity thus caused must raise prices but they are raised to a still greater extent, because this diminished quantity of goods is now exchanging against a larger quantity of money. As everybody in consequence has to pay more in money both the people and the Government need more money at the next stage. The Government trying to buy the same quantity of goods in the following week has to pay more than Rs. 5 crores and it issues more currency in proportion, unless it has obtained other resources in the meanwhile. It repeats the operation in this way the circle goes on there is a further gap in goods and consequent scarcity there is a still larger quantity of money in circulation against this diminished quantity of goods and the prices go on rising. Because of such rising prices, the Government and the people need more money and this becomes the excuse for further inflation, which is then justified as the demand of the people. This is a vicious circle. Inflationary finance causes scarcity scarcity causes high prices high prices require more inflation at the next stage. Each spiral of the vicious circle is therefore higher than the preceding. It is not correct therefore to try to distinguish between scarcity and inflation as the cause of high prices as has been done by some eminent persons¹ each of these three phenomena is at once the cause and effect of the others they all form the circle, the motive force of the circle being the issue of more currency notes from time to time.

(9) FULL EMPLOYMENT AND CURRENCY

Some persons have taken the view that we have still ample scope for further employment and further production in the country and that the remedy to prevent the rise in prices is not to check inflation, but to increase production and employment.² This reasoning reverses the process. Expansion of currency should follow or may accompany increase in production. If currency is expanded in the hope that production will be increased, the hope is bound to be frustrated as the production effort itself must suffer sooner or later by the rising spiral of prices and costs.

1 Cf. "Inflation or Scarcity?" by G. D. Birla.

2 Cf. G. D. Birla, Inflation or Scarcity? and S. N. Dutt, Inflation in Right Perspective?

Those who argue in this way have in mind the conception that so long as we do not have full employment we may expand currency to stimulate production. This is however conditioned by our capacity to achieve full employment under given circumstances. What is implied in the above theory is not the stage of maximum production and maximum employment to which a country may be potentially capable of reaching. What is implied is the stage of full employment which a country is capable of reaching at the given time under the given circumstances. Whatever increase in production was possible under our conditions has been achieved, chiefly in war factories. Most of the war factories are converted from existing establishments, there are only a few additions. Other factories under private control are able to increase production only to a limited extent, because they are not able to expand their plant and equipment, due to the want of machinery, which cannot be imported.

In agriculture, increase in production is still more difficult. The 'grow more food' campaign aims at the substitution of commercial crops by food crops. There is no great possibility of a substantial net increase in acreage nor of increasing the yield on existing acreage. These are problems which require time, and have not been solved by the efforts of decades by the Provincial Departments of Agriculture aided by the researches of the Imperial Council of Agricultural Research.

It is proper therefore to conclude that full production in the sense that whatever increase we were capable of achieving under the present conditions has been achieved. There are no reliable statistics to measure the extent of this production, but it is easy to see that the increase is not great compared with the total normal production of the country. Though it may be possible in future to increase production here and there, no substantial increase can be expected during the war. The small increase in currency which was justified by such limited increase in production was made long ago and further additions to the currency are wholly unjustifiable.

(10)' GALLOPING INFLATION

Inflation once started continues to develop fast, it has a tendency to develop into what has aptly been called 'galloping

inflation. This means that at each successive stage the dose of inflation is larger than before. In this connection we may consider the rate of the rise in note circulation which is given below

Increase in Note Circulation.

	(crores of Rs.)
1939-40	49-45
1940-41	19-11
1941-42	152-40
1942-43	<i>Progressive Total.</i>
April	32-55
May	50-59
June	61-94
July	69-75
August	93-01
September	111-34
October	133-44
November	159-11
December	189-11
January	212-00
February	233-00
Upto 26th March ¹	262-22

We find from the above that in the second year of the war the increase in note circulation was smaller than in the first in the third year however there was a sudden spurt to the note circulation—an increase of Rs. 152 crores in one year. During 1942-43 we find an addition to the note circulation of Rs. 262 crores. And the same tendency may continue perhaps at a still faster rate so long as the war lasts, unless other factors intervene.

(11) POTENTIAL INFLATION

Whether there is galloping inflation already in operation may be open to argument, but that the tendency is towards such a state of affairs cannot be denied. This may be aggravated by the

1. The increase in Note Circulation in recent months is given below —

	(Crores of Rs.)
	<i>Progressive Total.</i>
April 1943	34-03
May 1943	60-53
June 1943	79-78

existing idle monetary resources becoming active. We have seen above that to some extent such activity has begun in recent months, the percentage of advances and discounts to liabilities of scheduled banks shows some increase,¹ the percentage of cash of these banks shows some decrease. The sudden sharp rise in the price-level and particularly in the cost of living index in recent months also points in the same direction. Instead of tempering the rise in prices, these idle resources may serve as a powerful source of additional inflation. Unless steps are taken by which these resources are diverted to the state, we have a source of potential inflation in the present state of affairs.

(12) STERLING RESOURCES

The question naturally arises as to how and why this state of affairs should come about, and whether there is no way to get out of it. The Government of India purchases large quantities of war supplies on behalf of His Majesty's Government as well as other allied governments. A large amount of expenditure is incurred in India on behalf of these governments in rupees. The rupee finance required for all this is first found by the Government of India, which is subsequently reimbursed as explained in chapter I. For these reasons the British Government has to pay to India large amounts; these payments are made in London in sterling. While sterling may thus accumulate to the credit of the Government of India in London, it is all the time continuing the process of finding rupee finance for the above purpose in India. We have already seen that the UK paid Rs 505 crores worth of sterling to India by the end of 1942, that the estimate upto the end of the financial year 1942-43 may be put at Rs 555 crores. This indicates the amount of rupee finance provided in India by the Government of India on account of His Majesty's Government. We also estimated that the figure for 1943-44 may be Rs 300 crores or more. As already pointed out these transactions are not shown in the budget.

Another cause of the accumulation of sterling resources is

1 This means that the banks are now being asked to create deposit money by businessmen who ask for more loans, this purchasing power acts on prices in the same way as the ordinary currency media and becomes an additional cause of the rise in prices.

the excess of exports that we have since the war. From September 1939 to March 1943 the Reserve Bank purchased Rs. 382 crores worth of sterling from the exporters who obtained rupees in return. Part of the rupees could be found from revenue on account of Home Charges for which the sterling resources were used. The Home Charges amounted to Rs. 121 crores during the years 1939-40 to 1942-43, thus showing a large excess of sterling for which rupee finance had to be provided.¹ In any case, due to the combination of these two causes, large accumulations of sterling resources to the credit of India took place in London.

(13) REPATRIATION OF STERLING DEBT AND ISSUE OF NOTES.

It is this circumstance which explains two phenomena (1) the repatriation of our sterling debt and (2) the increase in our note circulation against sterling securities. Without going into the details of the schemes for the repatriation of the sterling debt, we may draw attention to the gradual reduction in the sterling debt from Rs. 469 crores in 1938-39 to Rs. 93 crores in 1942-43.

Whereas the holders of sterling debt in London were paid off in sterling by the Reserve Bank, rupee counterparts of this debt were issued in India partly to the public, and partly to the Reserve Bank itself. The amounts thus received enabled the Government of India to provide the rupee finance in India on behalf of His Majesty's Government and also for the exporters. It may be added that Indian holders of sterling debt were given rupee counterparts, and part of the debt was cancelled as it was thought that the Indian market would not absorb the entire amount of counterparts.²

Simultaneously with the above operation a beginning was made towards an increase in the note issue. Part of the sterling at the disposal of the Government of India in London was invested in sterling securities of the British Government and these were transferred from time to time to the Issue Department of

1. This question will be dealt with separately at the end of this chapter.

2. Out of Rs. 407 crores worth of sterling debt repatriated upto the end of 1942-43, only Rs. 234 crores of counterparts were issued.

the Reserve Bank. This enabled the Reserve Bank according to the existing law to issue corresponding amounts of rupee notes in India. These notes were naturally transferred in the first instance to the credit of the Government of India, who were in a position to acquire further supplies in the market with the help of this new purchasing power.

(14) EFFECTS OF THE ABOVE.

Out of these two reservoirs to find rupee finance, the one namely, repatriation of debt followed by new rupee loans, is anti-inflationary in its effect, the other namely, issue of more notes against sterling securities is inflationary. The repatriation of sterling debt was followed to some extent by the gradual withdrawal of monetary resources in the country from the people to the Government in the form of subscription to the rupee counterparts¹. The relative contraction of the money supply in the hands of the public must have *for a time* prevented the rise in prices due to the simultaneous process of an increase in the note circulation. The inflationary effects of the enhanced note circulation were thus for a time held back or concealed, they are now felt in their full intensity. As the amount of sterling debt to be repatriated is being exhausted, the Government of India uses the other reservoir of rupee finance, namely, additional notes to a greater extent than before, more so because the rupee expenditure in India on behalf of His Majesty's Government increases with the prolongation of the war.

The two reservoirs for finding rupee finance, and their relative volume is indicated below. This does not take into account ad-

1 The connection between rupee loans and repatriation of sterling debt is more apparent than real. Rupee loans need not have been issued as a counterpart to the repatriated sterling debt, which was paid off from the new sterling assets. Rupee loans were, however, issued to meet the revenue deficits due to war expenditure by the Government of India. The anti-inflationary effect referred to above is really that of rupee loans and the same effect would follow if more loans were raised in future. The fact that there may not be any more sterling debt to repatriate does not mean that more rupee loans cannot be raised in the country. It has been pointed out later that this is one of the ways in which rupee finance should be obtained in future.

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ditional notes issued against additional rupee securities.

	Decrease in Sterling Debt (in crores of Rs.)	Increase in sterling securities (in crores of Rs.)
1939-40	26.61	18.82
1940-41	97.56	51.65
1941-42	164.93	35.47
1942-43 (Estimated)	117.33	256.27

(15) ARTIFICIAL PURCHASING POWER.

With not much of sterling debt to repatriate,¹ the Government of India now resorts to the expedient of increasing the note circulation from week to week. What is the nature of the operation and what are likely to be its effects? For all practical purposes, this operation is similar to the creation of artificial purchasing power by means of the printing press by a Government in need as was practised during the last war by several countries. During the last war several countries printed notes and used them to obtain supplies from the civil population the value of the currency unit in consequence gradually fell to the value of the paper on which it was printed and prices rose at a rapid rate. The operation of the Government of India is similar inasmuch as it also creates purchasing power in its favour whose effects on the price-level in the country are also similar. There are, however two differences (1) that the notes are supported by a reserve in sterling securities 6000 miles away and (2) that these transactions are excluded from the budgets of the Government of India.

The sterling reserve, it must be remembered in no way gives any value to the rupee notes in circulation, just as the gold in the reserve in the Bank of England in no way gave any value to the paper pound, during the last war when it was not convertible into gold. The internal value of the paper rupee is entirely independent of the contents of the reserve its relative

1 Sterling liabilities of semi-government bodies, like municipalities, port trusts and also of public utility concerns can be repatriated in the same way in addition to the Rs. 93 crores worth of sterling debt still left at the end of March 1943

scarcity in relation to goods with which it exchanges alone determines its internal value and its increasing abundance must gradually result in a steep fall in its value in terms of goods. Because of the size of the sterling reserve, some people have been led to believe that the rupee currency is strong, in spite of its obvious weakness that we are experiencing everyday by the continuous fall in its internal value. This belief shows ignorance of elementary laws of money and of the experience of all countries since the last world war. In the currency laws of all countries, definite checks are provided against the overissue of notes by laying down certain conditions according to which the reserve against the notes should be constituted. In our case, sterling securities was the most important check, next to gold. The intentions of the law have been defeated by using sterling securities for a continuous expansion of the currency. The technical observance of the law creates the delusion among many that our note issue is supported by sterling securities, which somehow give a value to the rupee. They forget that the sterling link of the rupee is temporarily broken in practice by exchange control, and that the sterling securities no longer perform the function that they were intended to do, because they are at present as it were sterilised and cannot be used. Their only purpose at present is to serve as an acknowledgment of British debt to India, which however has been exalted into British generosity towards India. It is not easily realised that the rupee finance provided by the Government of India for His Majesty's Government is in effect a compulsory loan to Britain for which the sterling securities or the I O Us of the British Government are the visible evidence.

The other difference by which these transactions are excluded from the budgets of the Government of India also creates a misleading situation. The Government of India incurs expenditure in rupees for these transactions in the same manner in which it incurs expenditure for any other purpose which is entered in the budget. The fact that India is reimbursed in sterling for this expenditure in no way absolves the Government from the task of finding rupee resources for the purpose, once the responsibility for doing so has been undertaken by them. These transactions should have appeared in the budgets of the Government of India. By excluding these amounts from the budgets, it has been possible

to balance the budgets, partly by additional taxation and partly by loans or other resources as already explained. This has created the impression that the Government of India are following a sound financial policy for its war expenditure, and has diverted the attention of people from the fact that a large part of the war expenditure is financed by the Government of India by methods which are open to serious objections inasmuch as they amount to an inflationary policy. The fact that the Government of India have obtained a technical budget equilibrium by such methods has misled not only the layman but also competent students of the subject.¹

(16) INFLATION IN ITS NAKED FORM

We have referred to two reservoirs or sources of rupee finance. The one relating to loans uses the existing monetary resources of the people for war purposes. The other relating to issue of additional notes against sterling securities results in inflation which is limited only by the amount of sterling securities which can be put in the reserve, which in turn depends on the expenditure incurred in India on behalf of His Majesty's Government. There is a third reservoir which is unlimited in its capacity to satisfy the demand for rupees. This is the issue of notes against treasury bills of the Government of India. Treasury bills are a form of temporary loan which the Government raises in order to meet its current expenditure against revenue which may be collected during the course of the year. Bankers and other large investors who have funds to invest for short periods find Treasury Bills a convenient form of investment. If however the Reserve Bank accepts Treasury Bills and issues notes against them, it means that it creates purchasing power in favour of the Government against the I O Us of the Government. The temptation to obtain rupee finance in this way is the greatest because it is at first sight the easiest method. It costs only paper to the Government to

1. As an illustration of the wrong impression created in this way we may refer to a recent pamphlet by Mr S. N. Dutt, called *Inflation in Right Perspective*. In an otherwise able essay on the theory of inflation, Mr Dutt has failed to see how the practice of the Government of India conforms to the type of Monetary Inflation which he condemns on pp. 2-4 of his pamphlet.

create I O Us or Treasury Bills, and it costs only paper to issue notes against them. In other words, this type of note issue may be described as inflation in its naked form.

In order that such an issue of notes may be facilitated an Ordinance was issued in February 1941, by which the existing limit on the size of rupee securities that could be held in the Issue Department of the Reserve Bank was removed. By the proviso to sub-section (3) of section 33 of the Reserve Bank Act the Rupee Securities that could be held in the Issue Department were limited to one fourth of the total assets or Rs 50 crores whichever was greater. The removal of this limit made it possible for the Bank to hold Treasury Bills of the nominal value of Rs 174 crores at the close of 1942-43, as against Rs. 23 74 crores at the end of the year 1940-41¹. It is obvious that whereas the inflationary effects of the notes issued against sterling securities are sought to be concealed by the show of these assets, the issue of notes against Treasury Bills is only a legal fiction which makes it possible for the Government to obtain rupee finance against its own I O Us. This form of inflation which was rampant during the last war in Europe was severely condemned, because of its obvious dangers. It is exactly this form of inflation which is being now practised in this country.

(17) FINANCE MEMBER'S APOLOGY FOR INFLATION²

Referring to the increase in the Rupee Securities, the Finance Member was at pains to argue that this was not 'credit inflation'³. He observed that "these Treasury Bills merely replaced the sterling against which currency had already been expanded in the ordinary course in order to meet legitimate demands for the means for making cash payments, and the substitution merely amounts to a readjustment of the assets of the Reserve Bank's

1 Cf the increase in the amount of Treasury Bills as part of the debt of the Government of India under "Composition of the Debt."

2 This and the following section were published as an article in the Eastern Economist 22-5-43

3 The phrase 'credit inflation' is also applied to borrowing from banks instead of from the public. Such loans may not represent genuine savings and may lead to inflation

Issue Department.”¹ The legitimate demands for the means for making cash payments were of the nature already explained, namely to provide rupee finance for the British and allied governments. That this is not the ordinary course of expanding currency which is ordinarily done to meet genuine public demand, but a most extraordinary course, ought to have been admitted. If the sterling against which such inflationary expansion of the currency took place, is substituted by Treasury Bills, it does not in any way take away the inflationary character of the expansion. On the contrary it does reveal the fact that to this extent, the expansion of currency is backed only by the I O Us of the Government itself. The Finance Member may as well substitute the entire sterling reserve against which the present large expansion has already taken place, by such Treasury Bills and claim that such a process is not credit inflation. But it is obvious that he does not want to face this logical absurdity of his defence of this type of inflation.

Besides, his effort “to distinguish between pure credit inflation and the temporary situation in which an increase in the volume of purchasing power impinges for a time on a stationary or diminishing volume of consumable goods” need not mislead us. The temporary situation has already lasted for over three years and how long will it be prolonged, no one can say. This is a long enough period for the economic life of a country to be thoroughly disorganised by inflation, which will also prepare the way for further serious trouble by the inevitable deflation which must follow. This distinction and the suggestion that the effect of the increase in purchasing power is for a time may mislead the layman, but it will convince no one regarding either the nature of the inflation or its unfortunate effects on society.

The most remarkable observation of the Finance Member however was that the easy expedient of borrowing from the Reserve Bank has not been adopted for making up the revenue deficits of governmental budgets or for augmenting governmental balances for the purpose of meeting disbursements.” The Finance Member in the first place does not include in his budgets the figures relating to the rupee finance which he provides for the British and allied governments, and then claims that for the

1. Para 53, Budget Speech.

remaining expenditure he did not borrow from the Reserve Bank. If the correct position regarding the entire financing of the war which the Government of India does is included in the budgets as it ought to be, the fact that the Government has to borrow from the Reserve Bank for augmenting its balances for the purpose of meeting the entire war disbursements will be clearly revealed to the world. That this is so is indirectly, but perhaps unconsciously admitted by him when he says that "since disbursements must be made in Indian currency, the question of how war expenditure is allotted is irrelevant so far as the inflation aspect of the problem is concerned"¹

In order to minimise the extent of inflation, the existence of which he does not deny, he refers to the difficulty of making 'a quantitative determination of the phenomenon of inflation' because of imperfect statistics. In trying however, to make out a case that some expansion of the currency was necessary, he points out the public demand for currency. With the exception of the demand for more currency due to additional production, he does not realise that most of the new demand for currency arises from the policy of the Government themselves. We have already explained how under a policy of inflation a vicious spiral of rising prices takes place, which leads to an increased demand for currency both by the Government and the people. The effort to mix up genuine demand for currency with inflationary demand must merely add to the confusion.

The reference to 'an optimum price-level' which we did not have at the outbreak of the war and to the problem of stimulating prices before the war, does not look like 'playing the game'. The Government of India refused to take any monetary step when it was necessary to stimulate prices during the depression for many years before the war. The Government of India have not now adopted a policy of stimulating prices with a view to give an impetus to production and bring about an economic equilibrium in the country. Irrespective of this, they have gone headlong into a policy of inflation which raises prices far beyond 'the stimulating stage'. To mix up the results of two entirely different policies, in order to minimise the effects of inflation may

1 Para, 51, Budget Speech

mislead some for a time, but not for long, as the present policy is daily increasing economic disequilibrium in the country

A grudging admission of the gravity of the situation is however made by the Finance Member in these words—"This is not to say however that any of us can afford to evade the problem or to allow what may not be a serious situation to develop into one for lack of timely and vigilant action. It would be foolish to ignore the crux of the matter which is that in the lopsided economic set up of a country at war free purchasing power is a potential source of danger"¹ So far as the extent of the danger is concerned, the consolation offered by the Finance Member is that "there is not the remotest risk of inflation of the nature and on the scale which occurred in some of the countries which suffered utter defeat in the last war"²

It is a poor consolation for a patient to be told by his physician that he is not likely to be attacked by typhoid, without denying the fact that he is already suffering from paratyphoid. The Finance Member has taken no effective steps to prevent inflation³ he proposes to continue the present policy of financing the British and allied governments which must lead to more inflation and yet he asks us not "to take too pessimistic a view of the currency expansion that has taken place so far and that may be expected in the future."

(18) FINANCE MEMBER ON THE RISE IN PRICE OF RAW COTTON

Even while the Budget session of the Legislature was still sitting at Delhi in March, in spite of the advice of the Finance Member we found the clearest signs of a flight from the rupee, which is the strongest proof of the dangerous extent to which inflation had been already carried. The bullish heights prevailing in the share markets both in Bombay and Calcutta, as well as in the bullion and commodity markets provided evidence of this tendency. When this tendency affected cotton which suddenly soared high from a comparatively low level the Finance Member

1. Para 54, Budget Speech.

2. Para 51, Budget Speech.

3. This refers to the Budget session, March 1943.

was thoroughly upset, and observed in the Assembly on 17th March in winding up the debate on the Finance Bill, that 'he had rarely seen a more disgusting or disgraceful spectacle than that which was provided by that (cotton) market during the last few days. There was no justification to run the level of the price of cotton, as had been done.'¹ The Finance Member gave a warning in these words "If they indulge in this type of action Government will mobilise the whole of its resources in order to defeat and crush them. They have not only made it difficult to provide cheap cloth for the poor man, they have introduced a serious obstacle in our programme of crop-planning in order to secure the food production, which we need to solve the food problem. They have acted in the most anti-social way they possibly could. It is nothing less than economic sabotage. I assure the House that Government is certainly not going to take that kind of thing lying down and are going to take the most drastic steps to prevent it. I have learned a lesson from the behaviour of the market and if the speculators think I have said my last word on February 27 they may find they are badly mistaken."²

The Finance Member may be reminded that once inflation is allowed to take root, it spreads its tentacles in such a wide-spread manner, that it becomes impossible to deal with the symptoms successfully. If you take drastic action with one symptom and even succeed, other symptoms still greater in intensity will arise in unexpected quarters. It is to be expected that the Finance Member himself will take a warning from these events that the real remedy for such things is to stop the evil of inflation at the root without delay, instead of trying 'to defeat and crush' those, who prove by their action the existence of the evil, which he tried to minimise in the Budget Speech and in the budget discussions. Sir Purshotamdas Thakurdas in his observations on the remarks of the Finance Member pointed out the great disparity in the price of cotton and that of yarn and cloth, and observed that it was desirable that the cotton grower should get his due under the circumstances. In replying to the charge of economic sabotage, Sir Purshotamdas retorted that "any

1 Reported in *The Bombay Chronicle*, 18-3-43

2 *Ibid*

tampering with the price level of cotton and the return to the cotton grower would amount to sabotaging the economic interest of the producer." This shows how an inflationary rise in prices is general, and a disparity of the type that existed in the case of cotton could not continue for long. The Government of India must face the inflation issue directly and be ready to deal with it squarely and revise their own policy if they do not want the economic situation in the country to deteriorate further. The recent Ordinance prohibiting certain transactions on the Cotton Exchange may check speculative tendencies, but cannot affect that rise in the price of raw cotton which was inevitable under the present inflationary conditions.

(19) CHANGE IN THE ATTITUDE OF THE FINANCE MEMBER.

As against the effort to explain away the existence of inflation during the budget discussions in March 1943, the recent change in the attitude of the Finance Member towards the problem of inflation is refreshing. Within less than two months of the passing of the Budget, the Government of India introduced anti inflationary measures by Ordinances. The provisions in connection with the Excess Profits Tax and the regulation of private investment made in the middle of May 1943 by Ordinances have been discussed in appropriate places. We may here refer to the statement of the Finance Member in explaining these measures — "To the extent that money came into Government's coffers, the amount of money sent out into circulation would be less. If a hundred crores came in under the summary assessment a hundred crores less of *new money* would need to go out." This is an acknowledgment of the fact that Government are pushing large amounts of *new money* into circulation, that this is so undesirable that such extraordinary steps in the form of the new Ordinances had to be taken within a few weeks of the passing of the budget, and that to the extent to which the *new money* which Government may issue in 1943-44 is reduced because of this addition to revenue, there will be less inflation. As however the amount of money which Government will require by the inflationary process under the existing policy during 1943-44 is much larger¹ than Rs. 100 crores, the only consolation we can have

1. This was estimated at Rs. 300 crores in ch. III this may be exceeded under certain circumstances.

from these measures is that the dose of inflation during 1943-44 will be reduced by this figure. As the outside limit of this dose is uncertain and depends on the war situation in the East, we cannot say whether this will have a material effect on the situation. It is obvious therefore that this step shows a consciousness on the part of the authorities that their inflationary policy is wrong, and a desire to take some steps to mitigate the extent of its evils, but so long as the policy itself is not changed, the evil of rising prices cannot stop by such partial methods, though they may have a temporary effect.

(20) EXCESS OF EXPORTS AND REPATRIATION OF STERLING DEBT.

As an outstanding advantage to India of the method of payments to us in sterling adopted by His Majesty's Government, it has been claimed that the substantial gains to India due to the repatriation of sterling debt would not otherwise have been possible. In this connection, it is appropriate to examine in greater detail the sterling resources obtained by India during the war period independently of these payments. We have already pointed out that in addition to these sterling payments, the Reserve Bank purchased sterling in the open market in the usual way. As we have normally an excess of exports, there are persons who are willing to sell their sterling claims to the Reserve Bank for rupees. The Reserve Bank has to remit to England sterling in payment of 'Home charges' on revenue account, and is able to finance its sterling purchases ordinarily from the revenues of the Governments in India to which these charges are debited. During the war period, the amounts of sterling purchased by the Reserve Bank have been larger than usual. This is partly explained by the fact that our excess of exports over imports is much greater during the war. The amount of sterling purchased is however much greater than this excess, the exact explanation cannot be given as certain relevant data are not published on account of the war. The following table gives the figures of excess of exports and sterling purchased by the Reserve Bank since the war. After allowing for the payment of 'Home charges' in London, we find that the balance of sterling on this account was more than Rs 256 crores by the end of 1942-43.

During the same period the amount of sterling debt repatriated was more than Rs. 403 crores. It is obvious therefore that more than half the sterling debt repatriation has been done by these resources and could have been done even if the British Government did not pay us in sterling for their rupee requirements in India. If we further take into account the present tendency of our excess of exports and the purchase of sterling by the Reserve Bank, it would be safe to assume that India would have been able to repatriate her entire sterling debt by these means by the end of the war. If this process were followed, the rupees required to purchase the additional sterling in excess of our normal sterling charges, could have been obtained by the issue of rupee counter parts of sterling debt in India. The whole transaction could have been spread over a somewhat longer period and would not have involved inflation of currency.

Purchase of Sterling and Its Use
(in crores of Rupees)

	Excess of exports over imports.	Purchase of Sterling.	Home Charges.	Balance of Sterling.	Reduction in Sterling Debt.
1939-40	48.3	96.9	28.3	70.6	23.6
1940-41	41.7	76.1	29.6	46.5	97.5
1941-42	79.3	97.8	32.5 ¹	65.3	164.9
1942-43	84.1	122.2	48	74.2	117.4
		<hr/> 393	<hr/> 136.4	<hr/> 256.6	<hr/> 403.4

If we keep these factors in mind, it would be easy to see the connection between the sterling payments to us by His Majesty's Government, their conversion into sterling securities to be included in the assets of the Reserve Bank of India, and the issue of rupee notes against the same in India. In other words, if these two types of sterling transactions, namely the purchase of sterling by the Reserve Bank and the sterling payments to us by the British Government, were shown separately it would be easy to see that the cause of inflation in India is the method of payments to us in sterling and that we would have repatriated our sterling debt independently of these payments.

1 The Reserve Bank Report on Currency and Finance for 1941-42 does not give the separate charges for Burma but they have been taken to be the same as in 1940-41.

V

EVILS AND REMEDIES OF INFLATION

I EVILS

(1) EFFECTS OF INFLATION

In connection with the tendency of the price level to soar high continuously when inflation has begun, we should remember that it causes serious harm to the economic life of large numbers of people who find themselves suddenly reduced to poverty and want. Every rise in prices implies that the value of the rupee has fallen. Thus by now the value of the rupee has already fallen by more than half compared with the period immediately preceding the war. If prices still rise, the value of the rupee will fall still further. All those persons who have fixed incomes, salaries, wages, etc., find that though their incomes may be the same in money, their real value has suddenly gone down. This class of people cannot increase their incomes easily. True, organised wage-earners demand more pay and succeed in the long run in getting it. But this stimulates consumption rather than saving, and leads to still higher prices, thus aggravating the evil. Besides, those persons such as unorganised workers who do not succeed in getting a rise in their money incomes proportionate to the rise in prices must suffer¹. They must economise or live on past savings, if any. Except the few capitalist landlords, agriculturists are not able to obtain the prevailing high price for their produce because of defective marketing organisation, and whatever higher return they get in money has to be spent away in purchasing other necessities which have risen in price. Apart from this,

1 The dearness allowance granted to employees of Government and semi-government institutions has no relation to the rise in prices, in most cases it is a meagre acknowledgment of a difficult situation.

in modern times numerous transactions and contracts which are in terms of money lose their value because of inflation. The nominal value in money of such transactions, which the courts will enforce, remains the same, but their real value goes down suddenly. It is the experience of such disasters affecting the very basis of modern economic life which the peoples of Europe had in the last War that has made inflation so dreaded, and it is therefore that every government now plans to avoid it. The large amount of money wealth in the hands of some people which is caused by inflation creates a false sense of prosperity in the minds of certain sections of the people. They realise in due course that the real value of their money is fast going down, and that after all they are not as rich as they imagine. If inflation is allowed to take place, steps have to be taken later by deflationary methods to restore equilibrium. This process as was found by England after 1918 is equally disastrous and painful as it leads to depression and unemployment on a large scale. In an agricultural country which cannot respond to such changes quickly the process will be still more ruinous. If however the inflation goes beyond control there may be no room for any recovery in the ordinary sense as in Germany after the last War. It is well known that it was the wholesale ruin of German families due to inflation of the last War in Germany that made the way for the Nazis.

(2) IMPETUS TO HOARDING.

Inflation leads to hoarding of commodities including food stuffs. In view of rising prices those who can hold on to their stocks do so in the hope of getting a better return. Consumers prefer to buy large quantities, if they can, to avoid having to pay more in future. The hoarding of wheat in the Punjab and of foodstocks in other parts of the country by traders on the one hand, and the hoarding of food-stuffs by consumers in places like Bombay on the other is explained by the fact that inflation gives a direct and continuous impetus to such hoarding. This causes an artificial scarcity and the poor suffer in consequence this leads to feverish arrangements by the Government for price and food control and for steps to prevent hoarding. Such measures however desirable become extremely difficult to ad

minister, so long as the cause of the trouble, namely, inflation is not removed.

(3) INFLATION AS A FORM OF TAXATION

Inflation is the worst form of taxation. The Government puts itself in possession of a large quantity of fresh notes. It buys goods in the market with this money. This new money then becomes part of the circulation and competes with the old money for goods. The inevitable consequence is rise in prices, much higher than what would otherwise have occurred. The Government obtains the goods that it wants, the goods come from the hands of the people and the continuous diversion of goods from the public to the Government creates a scarcity which is shared by different people in different ways, because the new purchasing power is distributed unevenly among the people. The burden falls most heavily on the poor and the middle classes, they find their incomes suddenly losing value, and their capacity to obtain goods going down. The rich do not mind it because their money income increases during war, as they are able to obtain huge contracts at increasing prices for the supply of war materials. Unlike other forms of taxation, inflation thus falls most heavily on the less fortunate section of the people, and may lead to their gradual pauperisation¹. When a government is not able to finance war expenditure by the ordinary methods of taxes and loans, it resorts to this device of obtaining goods and services. The unwilling but heavy contribution which the people are thus made to give for the war is often greater than the direct contribution in the form of taxes and loans, and at the same time it causes undesirable repercussions in the entire economic fabric of the country.

(4) COMPARATIVE RISE IN PRICES

Before discussing the possibilities of the future, it would be appropriate at this stage to examine the effects of this inflation

1 Inflation may be compared to robbery. Both deprive the victim of some possessions, with the difference that the robber is visible, inflation is invisible, the robber's act is sporadic, inflation acts continuously, the robber's victim may be one or a few at a time, the victims of inflation are the whole nation, the robber may be dragged to a court of law, inflation is legal.

In the first place attention may be drawn to the fact that both in the U.K. and the U.S.A. where war expenditure is on a much greater scale than in India, timely steps have been taken to see that inflation is prevented. The results of these efforts some of which have been explained elsewhere, are visible at a glance in the following table¹ which gives the index numbers of prices in the U.K. the U.S.A. and in India.

Rise in Prices.²

	U. K. Economic Index No. 1929=100	U.S.A. Fed. Reserve Index No. 1926=100	Calcutta Index No. 1914=100	Economic Adviser's Index No. for India Week Ending Aug. 19 1939=100	Bombay Index No. 1914=100
1929	100.0	95.3	141		145
1932	67.8	64.8	91		109
1938	77.8	78.6	95		101
1939	80.3	77.1	108	121.1	109
1940	104.3	78.6	120	119.6	118
1941	114.4	87.3	139	129.7	137
1942 January	117.7	96.0	155	145.0	184
February	118.9	96.7	153	145.1	194
March	119.4	96.6	153	145.6	197
April	119.7	98.7	167	145.9	196
May	120	99.9	169	149.9	204
June	119.8	99.0	182	158.6	222
July	120.8	99.0	182	161.2	225
August	119.3	99.0	192	161.1	228
September	122.1	100	193	167.3	229
October	120.9	100	209	175.0	233
November	121.1	100	227	182.7	249
December	122.0		238	186.0	266
January	122.8		250	195.6	255
February			253	200.4	255
March			272	220.1	256

1. The base year for the different index numbers given above is not the same. For a perfect comparison, a common base year would be desirable the method of calculation and the commodities selected should also be similar. As it is not possible to have such perfect data for all countries, we have to be satisfied with what is available. The general tendency reflected in the table would not be affected even if more perfect data could be had.

2. Recent figures in some cases are not available.

The activities due to the war in the first place gradually lifted the abnormally low level of prices current in the U.K. and U.S.A. at the beginning of the war. In the U.K. where the war expenditure has been of a longer duration than in the U.S.A. the average level of prices reached in 1941 increased only by 8 points in 1942. In U.S.A. the price-level reached 100 in October 1942. More recent figures are not available, but if we remember the comprehensive anti-inflation measures introduced in the U.S.A. we may take it that though there may be a small rise, the price level in the U.S.A. by now would not be much above 100.

Compared with the experience of the last war, this is a creditable performance for both the countries. Both the authorities and the people of these countries are anxious to avoid the evils of inflation, whose memories are still fresh, and almost since the outbreak of the war a systematic attempt has been made so to control the financial policy of each country that inflation shall be checked. Colossal amounts have been spent on the war in these countries without unduly raising the price level. In the first place taxation was pitched high from the beginning, and all the avenues were explored to encourage and increase savings and divert them to the Government in loans for the war. It was by diverting an increasing part of the national annual income that the war was sought to be financed¹. In pursuance of the same policy ingenious schemes such as limitations of dividends, and deferred pay on the lines suggested by Keynes were introduced. The same policy was responsible for the liquidation of British investments in foreign countries. By utilising these capital resources to obtain supplies from abroad the strain on current finance was reduced and inflation was prevented. Simultaneously with this, measures for the control of prices accompanied by a system of rationing were introduced. The people cheerfully co-operate in these measures of economy and sacrifice in the national cause which they feel to be their own. In the U.S.A. similar measures involving heavy taxation and saving have been introduced. The arrangements for price control in the U.S.A. are perhaps more thoroughgoing and far-reaching than in the U.K. as we can see from the recent legislation in America.

1 Some details of these measures are given at a later stage.

(5) INEFFECTIVE PRICE CONTROL IN INDIA.

Compared with this we find that the price level has been allowed to shoot up to 272 in India in March 1943 the rise being particularly heavy during the year 1942-43¹. So long as inflationary measures are adopted in the country without adequate safeguards no amount of price control will have any effect. Under such circumstances price control becomes merely a cloak to deceive the people and throw the blame of the rise in prices on shoulders other than those of the Government. It is well known that price control measures adopted in this country have been more on paper than in practice that there is confusion about the price control policy both among the officials who are supposed to work it and among the public who are supposed to benefit by it. The pronouncements of Mr Sarkar while he was Commerce Member showed that the Government of India were aware of their failure in this connection and steps were in contemplation to remove defects in the existing policy. It may however be pointed out that the only sphere in which the Commerce Department can help is by organising the food supply of the country so that there may be more food on the whole, and a proper distribution of the same. The Commerce Department will be powerless to control prices in general so long as the Finance Department is following a policy which must lead to an ever increasing price level. Even in the matter of food supply it may be pointed out that there is a definite impetus to those who hold stocks to wait for a more favourable price, and as the price is ever on the increase, they may try to hold out as long as they can. Hoarding of food may therefore continue and the problem of arranging for the disboarding of stocks of food with inflation on the increase will present insuperable difficulties.

1 The actual rise in prices must be higher than that indicated by the index number. Those responsible for making the index number would not take into account the prices current in the black market. In fact, they would not ordinarily know these prices. As the black market is in several cases the predominant market, and the control prices operate only to a limited extent, the people on the whole are paying a much higher price for most commodities than indicated by the Official Index Numbers.

II REMEDIES

A. CORRECT METHODS OF RUPEE FINANCE

(1) DEMANDS FOR RUPEE FINANCE IN INDIA

As we have already seen, irrespective of the allocation of war expenditure in India, the Government of India has undertaken to provide the rupee finance necessary to finance the entire war expenditure in this country. For the purposes of understanding the nature and volume of rupee finance, which is required, we may attempt a rough classification as under —

- (a) For excess of exports on private account. We have seen that this led to the purchase of sterling worth Rs. 344 crores since the war upto the end of 1942-43 against which rupees had to be given in India.
- (b) For the defence of India proper the determination of this has become difficult because of the way in which the Military Machine is organised and run.
- (c) For additional expenditure that India is asked to bear by an elastic interpretation of the Financial Settlement, or by further changes in the same in the future. We have seen that the total charged to India was Rs. 553 crores upto 1942-43 plus Rs. 200 crores budgetted for 1943-44.
- (d) For financing the requirements of the British Government in India, that is for the portion of the war expenditure in India, which the U.K. bears. As explained above, the figures of this are not published. We have estimated the amount at Rs. 555 crores upto the end of 1942-43 and at Rs. 300 crores for 1943-44. This may be considerably exceeded.
- (e) For financing the requirements of the American Government in India. The figures of this are also not published, though a provisional estimate of the amount which India is to bear for reciprocal aid is shown. This latter is included in (b)

- (f) For financing the requirements of other Allied Governments in India, for which no information is available

Is the Government of India in a position to find the resources for these demands for rupee finance? We have seen that taxation is carried to a high pitch. Loans have been raised to supplement revenue, and the Finance Member has appealed for more loans in his budget speech in March last. But these two sources together have not sufficed in the past for the aggregate war expenditure in India which the Government of India finances. Their ways and means budget is therefore in deficit, the exact amounts of which have not been published. In order to meet these deficits, they have adopted the easy method of creating artificial purchasing power by printing more notes, thereby leading India on the high road to inflation and consequent economic disequilibrium. It is obvious from the Budget Speech and discussions on the budget for 1943-44, that the Government of India propose to continue this policy.

(2) PREVENTION OF INFLATION AT THE ROOT

If the Government of India are anxious not to involve the people of this country into economic chaos they should think immediately of alternative means of financing these requirements and put a severe brake on the inflation which has started at the root. In the first place, we shall consider the steps to be taken in connection with the financing of the requirements of the British, American and other allied Governments. The simple fact which has to be remembered in connection with these requirements is that India is the seller of goods and services, the allied nations are the buyers. The seller should be in the position to lay down the terms of the sale and particularly the method of payment. This is a common practice in private business dealings, it is all the more necessary for business dealings between countries. According to international practice, the British and American Governments should either pay us in goods and gold or raise rupee loans in the country from the people of the country to finance their requirements. They may also achieve the same object by liquidating their assets in India and by converting them into rupees.

(3) PAYMENTS TO INDIA IN DURABLE ASSETS.

Let us examine these methods in greater detail. In the first place, the accepted method of international payments is goods or gold. It should be possible for the U.K. and U.S.A. to send to India durable commercial assets for which rupee investments from private sources would be forthcoming. Industrial equipment has been moved from the U.S.A. to Russia in spite of the hazards of the war. It would not be impossible for similar feats to be performed by the U.K. and the U.S.A. to enable India to be a more effective partner in the war. The demand for example, for an automobile industry or ship-building industry in India is insistent and has been shelved on one ground or another. The need for building locomotives at the present moment is most urgent, and would greatly ease the transport problem in India. Instances could be multiplied to show that the prosecution of the war could be helped by such a transfer as it would lead to the manufacture of war materials on the spot and save valuable shipping space and transport delays. There are incidental advantages which can be obtained by sending such goods in payment of materials and services which the U.K. and U.S.A. get from India.

(4) PAYMENT TO INDIA IN GOLD.

The other method of payment is to send gold to India. It may be argued that it would be hazardous to send gold to India at present. The only answer to this is that gold and silver have been exported from India to U.K. and U.S.A. during this war and there is no reason why the reverse voyage cannot be performed by the precious metals. If it is considered dangerous to do so it should be possible to earmark gold for India, say in South Africa or the U.S.A. It may be added that if such earmarked gold is treated as part of the currency reserve, notes will have to be issued against the same. The issue of additional notes can be avoided only if the gold is sold to private parties who may give rupees in return for the same.

(5) RUPEE LOANS BY THE U. K.

The other alternative of issuing rupee loans in India on behalf of the British Government may now be considered. When

we bought British goods for the last so many years on capital account for building railways, irrigation works or such other schemes, we had to pay the British suppliers of these goods in their own currency and, therefore, had to find the necessary amount of sterling. As India was not in a position to pay these amounts, sterling loans were floated in London on behalf of India. One set of British citizens subscribed to the loans, the Indian Government obtained the sterling, which was paid to another set of British citizens who supplied the goods. India had to pay the interest on these loans all these years, and has been able to repay the capital now. In the same manner, when the British Government bought goods from the U.S.A. during the last war as well as this war, they were called upon to pay the American suppliers in dollars. As the British Government did not have the necessary amount of dollars, they raised the same either by liquidating British investments in America or by raising dollar loans in the U.S.A. The 'cash and carry' terms on which America sold goods to the British in the early years of the war also resulted in such operations.

In the same way for the large purchases of goods and services which Britain and America are making in this country, the burden of finding the necessary rupee finance should really be on them. Instead of adopting this natural process, the unnatural process of paying us in sterling has been adopted, and it is left to the Government of India to find the rupee finance to pay the Indian suppliers of goods and services to Britain. If this unnatural process is reversed and the natural process adopted, the solution of the difficulties in which India is involved is easy. Just as India raised sterling loans in the past, the U.K. should raise rupee loans now. This can be done as usual on the credit of the revenues of the British Government, the Government of India may give a guarantee to the investors. A further security is available in the form of British commercial assets in India, which should inspire the necessary confidence in the mind of the Indian investor. British investments in the U.S.A. have been similarly pledged to raise dollar loans. It is possible that in spite of such security the existing political tension may come in the way of the success of such loans. If that is so, it is a valid reason to take steps to end the political deadlock and restore that confidence and

goodwill which are necessary for good business relations between any two countries.

(6) LIQUIDATION OF BRITISH ASSETS IN INDIA.

The same object may be achieved by the liquidation of British commercial assets in India which are estimated at £300 million. Similar steps were taken by the U.K. in the last war and have been adopted to a greater extent in this war particularly by liquidating British investments in the U.S.A. to obtain dollar resources for the purchase of American goods for the war. The British have to appease the people of India and raise rupee loans in the country as suggested above or in the alternative liquidate their assets in this country for which private investors in rupees should be available with ease. The British people have to decide whether they would obtain genuine rupee finance in either of these ways for their purchases in India, or whether they would continue to force the unnatural process of paying India in sterling and asking thereby the Government of India to continue the policy of inflation.

(7) EQUITABLE RETURN FOR OUR GOODS.

The method of payment now in operation for the purchase of Indian goods by the U.K. and the Allies is determined by the buyer. The buyer pays us in sterling in London. The seller Government is left to finance the purchases within the country in the bargain we have more notes and inflation. As a member of the Empire, we may be called upon to mobilise our resources and supply the goods, but surely this supply should not be done in a manner by which we run ourselves and upset our entire internal economy. It is in order to escape from this impossible position in which we as sellers of goods to U.K. have been involved, that the above proposals have been made, which in the aggregate indicate fair methods of payment for our goods. The result will be that we shall be able to send the goods required, but *shall not suffer* in the way in which we now do and shall obtain a just and equitable return. We have suffered from all the disadvantages of a debtor nation since the British connection. We are now in the position of a creditor. But the present policy denies the full and real advantages of a creditor position to which we are in justice entitled. The adoption of the correct methods

of rupee finance outlined above will not only prevent the further dangers of inflation at the root, but will also enable us to reap substantial fruits of our creditor position, which would otherwise be lost

(8) PROCEDURE FOR RAISING RUPEE FINANCE FOR U K

In connection with the above suggestions for rupee finance for His Majesty's Government, it would be appropriate to indicate broadly the several alternative procedures which are available in practice. In the first place the normal procedure should be for the British Government to raise loans in India with the assistance of the Reserve Bank of India. This is in conformity with their practice in other countries. The second method would be an inter-governmental loan. The Government of India may raise rupee loans in India and then loan the same amounts to the British Government. Under this scheme, there would be proper arrangements for the payment of interest and capital to the Government of India, so that there would not be any net burden on the Indian tax-payer on this account. The third alternative is for the Government of India to provide the rupee finance to the British Government, but limit the same to the amount it can raise by means of taxes and loans over and above what it requires for its own expenditure.

This last alternative is suggested in the Economists' Manifesto¹ issued on 12th April 1943 by leading Economists in the country. Among other things they observed that "We would also emphasize that the total liabilities undertaken by the Government of India, whether on their own account or on account of the British and Allied Governments, should not exceed the resources that they find possible to raise in pursuance of the policy outlined by us"

In the first two alternatives, all the transactions would be in rupees, and the British Government would have to pay us ultimately in rupees directly to the investors in the first method, and to the Government of India in the second method. In the third alternative, the payment in sterling is permissible, with this difference that we shall then have 'sterling balances' which will

1 The text of the Manifesto is reproduced in Appendix I

not be part of the sterling assets of the Reserve Bank of India against which, notes may have been issued in India.¹ In other words, in each of these methods, inflation is avoided. Those who have objections to these methods should decide whether they would prefer inflation to the supposed or real difficulties of these methods.

(9) THE ATTITUDE OF THE FINANCE MEMBER RE THESE SUGGESTIONS.

The reply of the Finance Member to these suggestions² may be found in the following remark —“In a common war effort the usual methods of settling international indebtedness in goods and services are not available and for a variety of reasons it is not possible to give play to the usual checks employed in order to adjust international trade relations, i.e., it is not possible to increase the volume of commercial imports or to adjust the trade balance by an upward movement in the rate of exchange”³ Even if we accept these vague remarks so far as payment to India in gold and goods is concerned, it is obvious that the Finance Member is silent on the most important point in the whole issue, namely that the responsibility for finding the rupee finance for their requirements in India should rest on the British and Allied Governments. That there are well known methods of raising such finance in India even during war as has been done by the U K. in the U S. A. and in some of the Dominions, is not denied by the Finance Member. The irony of the situation is that this finance is provided by a process which causes the most severe hardship to the people of this country which is wholly ignored in considering the financial contribution of India to the war and the payment which the U K. makes in return in sterling is done in a manner which is most conducive to her own internal requirements and her own anti inflation policy⁴ and yet this sterling payment which is the basis of inflation in India is paraded to the world as the generous contribution of the U K. for the defence of India. The problem of these sterling balances will be discussed at length in the next chapter but it is appropriate to point out

1. This will be discussed more fully in the next chapter

2. These were made in “the Falling Rupee,” pp. 22-25

3. Budget Speech, 1943-44, para 51.

4. Cf. Ch. VI, p. 126

here that the present arrangements cause considerable economic dislocation in the country and will prepare the way for the most serious depression in the future, and that the complete indifference to any effective alternative to this on behalf of the authorities, shows that the U K is not willing to shoulder the responsibility for rupee finance in India which is really hers, because she would then have to give up the solid indirect advantage which she now derives by the method of paying us in sterling. History will decide whether the U K was generous to India in this connection or managed the financial policy of war in India in such a manner that she may have to do the minimum sacrifice and throw the maximum burden on India, yet presenting the Indian Budget in such a way that the world could be misled into the myth of the British paying for the defence of India.

B ANTI-INFLATION MEASURES

(1) THE OBJECT OF ANTI-INFLATION MEASURES

Along with the adoption of correct methods of rupee finance as outlined above, other anti-inflation measures should also be put into operation in India without delay. These measures may be classified into three categories — (1) those relating to taxation, (2) those relating to loans, and (3) those relating to price control and control of articles of consumption. The object of the first two types of measures is to divert as much of the purchasing power as possible from the hands of the people to the Government. The effect of this is that Government obtains the resources necessary for purchasing goods and services for the war, and the amount of purchasing power left in the hands of the public is reduced with the consequence that their demand on the smaller quantity of goods available for civilian consumption is restricted. In spite of this, due to the prevailing inequalities of wealth and income, there are bound to be certain classes of people in society who can draw to themselves a comparatively larger share of the available stock of goods by paying higher prices. If this is allowed to continue, the less fortunate section of the people who are in a large majority, will find it extremely difficult and sometimes impossible to obtain even essential things of life. Such a state of affairs during war time when all classes of people are asked to co-operate in the war effort would not only break the

civilian morale but may also lead to an internal revolution making the successful prosecution of the war impossible. It is in order to prevent this contingency that the third group of anti-inflationary measures are adopted. The object of price control is to keep within reasonable limits the prices of things in general and of essential things in particular by regulating the operation of the laws of demand and supply. As this is extremely difficult in practice unless either demand or supply of goods can be controlled, arrangements are made to regulate the production, and distribution of essential articles by a system of rationing, which involves the control of supply of goods which are rationed. It is by the combination of these methods that the inevitable rise in prices which occurs during war time is brought under control, and all classes of people assured a reasonable existence. Incidentally this releases the surplus purchasing power with the well-to-do for war loans.

On account of the experience of the last war the realisation of this object is considered the most important aspect of war policy in the home front, and the Government in most other countries have themselves put the most severe brake on their own temptation to adopt an inflationary policy. The financing of war by printing additional currency notes is avoided by all possible means, because it is realised that the sacrifices involved in additional taxes, additional loans and measures of price control and rationing are desirable in the national interests in order to avoid the calamity which would result from a policy of inflation.

(2) ANTI INFLATION MEASURES IN U K. and U S. A.

We shall now refer briefly to anti inflation measures in the U K. and the U S. A. and then consider such measures adopted in India. In the U K. an increasing proportion of war expenditure is raised from revenue. The percentage of revenue to total war expenditure in the U K. was 48 in 1941-42 52 in 1942-43 and is estimated to be 56 in 1943-44. The total war expenditure in the U K. since September 1939 to the end of 1942-43 is estimated at £15 000 million of which £8,677 million have been raised by loans. Thus this huge expenditure has been financed partly by taxes and partly by loans. Among taxes, direct taxes are the

most important. In order to illustrate the effect of taxation on higher income categories, we may say that for all practical purposes under the measures now adopted in the U.K. no individual income after paying taxes shall be higher than £6,000 a year, and only a small number of persons are able to have net incomes above £4,000 a year. As a result of the savings campaign, and reduction of consumption by heavy sales taxes, since the beginning of the war, £30 million a week have been saved and invested in war loans. At the same time by an effective system of rationing and price control the poorer sections of the people are assured the essentials of life. Wages and salaries have been allowed to increase to some extent, but it is realised that any further increase in income may create a gap between the civilian purchasing power available for the purchase of consumers' goods and their total value at current prices at a progressive rate. Suggestions therefore are made by which a brake may be applied to further increase in wages and salaries.

In the U.S.A. taxation has been similarly pitched high, ceilings have been put to personal incomes, and savings are encouraged and mobilised. At the same time the Anti-Inflation Bill which was passed in October 1942 was implemented without delay. The legislation authorises the President to fix wages, salaries and prices at the levels existing on 15th September 1942.

(3) ANTI-INFLATION MEASURES IN INDIA

We may now consider how far such measures have been applied in India and should be applied hereafter in order to raise the rupee finance for the total war expenditure in India, irrespective of its allocation, and thus prevent inflation. In considering these measures, we shall bear in mind the point that however unwelcome this or that measure may be to certain sections of the people, or however difficult such measures may be from the point of view of administration or constitutional propriety, it is better to face them in order to remove the far greater evils to society by the continuation of inflation. It is only this overriding consideration of saving the country from the inequities and horrors of inflation that measures which involve immediate sacrifice have to be adopted.

(a) *Retrenchment* In the first place, the Government of India should set a good example by cutting down all expenditure to the minimum. Large expansions have taken place in the existing departments new departments have cropped up. The recruitment to these departments has been on a lavish scale. By offering unusually large salaries the Government has tried to attract people to these services. In the absence of national sentiment for war service, the Government offered a large monetary inducement for war work. By doing so the Government has added to its own difficulties. It has increased the amount that the Government has to spend on these services. Those who have obtained these large salaries are in the possession of greater purchasing power than others, and therefore able to pay higher prices for the diminished stock of goods in the market. This tendency is reflected in the Provincial Governments, where war time expansion of government work has led to a similar situation. Private employment has not escaped the infection. In the case of private employers there has been another inducement to pay higher salaries, or war allowances or bonuses to their staff. All such additional expenditure reduces the Excess Profits Tax, and is at the cost of the Treasury. It is possible that in some cases such extra remuneration is justifiable but the fact remains that this adds to the inflationary situation in the country.

(b) *Taxation.* Taxation has been raised to a high pitch since the beginning of the war. Large additions were made in the budget for 1943-44. It is possible, however as explained in Chapter II to raise more taxes from those few rich persons whose net incomes at present are above a particular figure. Agricultural incomes above a particular limit should also be brought within the same category. This would be in conformity with the principle of ability to pay to which reference has been made in the Economists Manifesto.

It is possible that there may be some scope of additional taxation in the Provincial sphere. For example, the Urban Property Tax levied in Bombay may be extended to other Provinces. Provincial Governments may be encouraged to have a surplus in their budgets by retrenchment on the one hand, and greater taxation on the richer classes on the other. The surplus may be invested by each Province in War Loans the amount

would thus be a reserve available to the Province in future for schemes of development. During the period of post-war depression, if the Provinces are able to spend such reserves on desirable schemes, they will ease the difficulties of the depression

(c) *E P T Ordinance* By a new Ordinance in the middle of May 1943, certain changes were introduced in the system of E P T with the intention of recovering large arrears, of having speedy assessment and collection of revenue in future and of removing possibilities of evasion. It was found that large arrears of E P T were outstanding mainly because of delays in procedure. To remove this, a system of summary assessment has been introduced. A safeguard has been provided by which if it is found that a refund is due to the assessee when the regular assessment is made, it will be paid with interest at 5 per cent. This is by way of a guarantee to the assessee that the new procedure will not be used to his disadvantage.

The Ordinance further provides that rules will be made by which the amount of bonuses and commissions which will be admissible for income-tax purposes will be prescribed. The object of this is to check the present tendency by which bonuses and commissions are increased at the cost of the Treasury. With the same object, the amount of stocks which a concern may be allowed to hold for income-tax purposes will also be determined. This is also intended to prevent hoarding of goods by such concerns.

The Finance Member has estimated the arrears of E P T at about Rs 100 crores. The fact that such large amounts of money were in the hands of people due to be paid as tax, must have added to the recent speculative boom in various markets. If we take the above provisions into account, the amount of E P T estimated in the budget for the year 1943-44 should be put at a higher figure.

In this connection, the use of advance tax-certificates which have been adopted in other countries may be recommended. Such a system would go far in removing the type of tax arrears to which the Finance Member referred, and could be applied to several taxes. The immediate diversion of surplus purchasing power from the public to the Government can thus be effected.

(d) *Loans* The methods of raising additional loans have been discussed in the chapter on Public Debt. We have sug-

gested that the recent provision by which Excess Profits Tax payers are required to pay $13\frac{1}{3}$ per cent. of the profits as a compulsory loan should be carried to its logical conclusion by bringing the remaining $6\frac{2}{3}$ per cent. within the same rule. We have also suggested compulsory loans from employees of Governments and semi-government bodies where salaries are above Rs. 6,000 a year. A similar arrangement should be made in the case of employees of private employers also. We have also suggested above loans by Provinces from their surpluses.

So far as voluntary loans are concerned, the recent savings campaign started in the U.P. will provide useful experience. It may however be pointed out that the success of such campaigns will depend greatly on the political situation in the country.

The regulation of private investment and the narrowing of the channels of investment which has been adopted recently should also enable the Government to raise more loans. We have also made suggestions for the diversion of part of the dividends of companies and of cash bonuses of workers to war loans.

(e) *Price Control*. This important question with special reference to food supply has been discussed by us in a separate volume.¹ We have shown that the price control in India is of the most desultory character. Even in the case of essential articles of food, it has failed miserably. The attempt to control the price of foodgrains at the primary wholesale stage has been abandoned. Some provincial governments act in a manner by which the aims of price control are defeated and there is want of co-ordination between the Central and Provincial authorities. The idea that the whole country should be treated as one producing and consuming unit in the matter of essential foodgrains, the therefore the policy should be laid down by the Centre, which should be carried out by the Provincial Governments and the States in a spirit of co-operation is conspicuous by its absence. In consequence, articles of food have gone up in price by 200 per cent. and in some cases more.²

1 Price Control and Food Supply by C. N. Vakil, J. J. Anjari and D. T. Lakshadwala.

2. Food rationing has been introduced in Bombay City and a few other urban areas.

It is a pity that such a vital problem is still in the deliberative stage. The recent Food Conference held in the beginning of July resulted in a compromise between vested interests instead of a real drive for assuring a proper distribution of food to the country as a whole. The unnatural distinction between surplus and deficit areas still continues, and the deficit areas are left at the mercy of the surplus areas for their food requirements. There are measures against hoarding and profiteering of food which are to be intensified. But the Government of a surplus Province may hoard and profiteer, or encourage the same within its area with reference to another Province. Responsible Ministers of some surplus Provinces have openly advocated this policy and taken pride in it. Well might the consumer in the deficit areas say, 'Why not invoke the Defence of India Rules for such public enemies of country?'

A special Committee has been appointed to review the Food Problem and suggest a long-range policy which will be discussed at another Food Conference in September. In the meanwhile, prices of articles of food continue to rise, the prices of even controlled articles have had to be raised recently in some areas.

(f) *Cloth Control* The rise of prices of cloth is about 500 per cent. No attempt was made till recently to control the production and distribution of cloth. The schemes for standard cloth have been talked about for a long time without any result. Even if the schemes materialise, the production of standard cloth will not be adequate for the requirements of the people. Instead of piecemeal efforts such as the control of prices of raw cotton, it is desirable that the whole problem should be attacked simultaneously in a thoroughgoing manner. In this connection a press communique was issued by the Government of India on 27th May to the effect that the measures regarding the control of cotton prices were intended to lead to a comprehensive scheme of cloth and yarn control designed to produce an increase in production and to ensure that cloth and yarn reached ultimate consumers at reasonable prices. An agreement has been reached with the industry about the cloth control scheme,¹ and it is hoped that the scheme will be successful.

1 The Scheme is discussed in Appendix II

(g) *Ban on Forward Transactions* Another series of steps taken by the Government of India during the month of May 1943 constitute a ban on forward transactions and put the trade on a cash basis. This was done first with reference to cotton it was then applied to other markets, such as seeds and bullion. The obvious intention of these measures is to check the rise in prices. It must however be pointed out that assuming that these measures are successful, their only effect will be to control the speculative element in the price level this will not affect the inflationary trend. As the News Chronicle (London) put it, these measures are like plugging the thermometer to stop fever. In other words, they do not affect the real disease of inflation, even if they blunt the edge of the speculative element in the price level.

(4) ADMINISTRATION OF ECONOMIC CONTROLS.

Economic controls of the type referred to above, particularly control of prices of essential goods such food and cloth, control of profits and wages, regulation of private investment and so on are easy to justify in principle in order to avoid inflation. But what is good in principle may become unwelcome to the point of disgust and opposition if these controls are not handled properly. In the first place, the administrative officers of Government old or new have no experience of economic controls. They may not realise that the outlook and approach in the administration of such measures is different from those of ordinary administrative work of preserving law and order in normal times. They often forget that economic controls by their very nature alienate the sympathies of the people, and create *bitterness and antagonism* in the minds of those affected. They are tolerated as necessary evils for the greater good for the country as a whole, when there is a consciousness among the people for their need, and consequent willingness to co-operate with the administration.

The average I.C.S. officer who is put in charge of such controls is an object of pity inasmuch as on the one hand, as a rule, he is not well equipped for the task on the other the essential background for the success of such measures does not exist due to the political tension in the country. If he bungles as he is bound to in most cases, he will alienate the goodwill even of those persons who are not politically minded, but who resent

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such measures because they affect their chances of gain or because they disturb their routine of life to which they are accustomed. One of the chief reasons of such bungling is due to the absence of the knowledge of how economic forces work and how business is carried on in practice in this or that trade. In other countries the advice of those who are in a position to help is willingly sought by the administration, wherever possible experts are appointed to do the work. The only experts that the Government of India are able to find are from England, if a departure is made from appointing an ICS man to such key positions, it is in favour of a so-called expert imported from England. Such experts work under the severe handicap of a total ignorance of local conditions and learn by committing mistakes at the cost of the people. In any case, such experts are not able to command that confidence among the people, which is necessary for the success of economic controls. The practice of appointing superannuated officers of other departments to such posts leads to the charge of favouritism at the cost of efficiency.

The result of this situation is that the belief in the necessity of such controls has been shaken, and there are important parties in the country who feel that the extension of the system of controls is not proper under the present administration. This belief is also partly due to the half hearted controls which have been in existence hitherto. Half-hearted or partial controls are worse than the absence of any control. They have all the effects of absence of control in an intensified form, namely, the prevalence of black markets.

The inherent difficulties of administering economic controls in a country like ours are intensified by the above factors. Unless the Government of India take timely steps to remove these factors both in the political and the administrative spheres, they are likely to meet with increasing obstacles in carrying out their anti-inflationary policy. In other words, the paramount needs of an anti-inflationary policy may force the Government to introduce those desirable changes in the political and administrative spheres for which they have otherwise shown a supreme indifference.

(5) TEST OF SUCCESS OF ANTI-INFLATIONARY MEASURES

The recent measures taken by the Government of India may lead to a state of complacency. The same parties which refused

to believe in the existence of inflation or winked at it are now loudly proclaiming the achievements of the Government of India in the sphere of anti-inflationary policy. Some of them have exaggerated the effects of these measures, and in their desire to do so have indulged in economic fallacies. For example, in connection with the collection of Rs. 100 crores of E.P.T. arrears by summary assessment and the savings drive in the U.P. it was frequently stated that such large amounts of money would be "immobilised." As a corollary to this, it was believed that this would lead to deflation or falling prices.¹ It must be realised that the transfer of purchasing power from the people to the Government either by taxes or loans does not immobilise it in the sense that it is withdrawn from circulation. The money is spent by Government and, in war time it is spent quickly and in large amounts it thus remains in circulation. The main desirable effect is that so much less of new money will be issued by Government to finance the war. The process is anti-inflationary in the sense that it thus reduces the amount of inflation which would otherwise have taken place. It will thus prevent the rise in prices which would have occurred because of inflation. It is not deflationary in its effect inasmuch as it cannot lower prices. There has to be a withdrawal of excess currency from circulation to constitute deflation which would in consequence reduce the price level.

In other words, the process of such transfer of purchasing power from the people to the Government has to be continuous in order that the same stock of money may do the work of financing the war. The amounts spent by Government become the income of some people who receive the money. The money thus goes back into circulation the people pay again in taxes and loans and a fresh transfer of the same money takes place from the people to the Government. It is by such a process of continuous transfer of purchasing power between the people and the Government that the British Government has been able to spend several millions a day without resort to inflation.

1 E.g. *The Times of India* of 24-5-43 published a statement from its special correspondent at New Delhi on Savings Drive in U.P. and commented on the same on 26-5-43 in a leading article entitled *Deflation by Saving*.

The test of the success of anti-inflation measures in India therefore is whether the diversion of purchasing power from the people to the Government is continuous, and whether in the aggregate it is large enough to finance the total war expenditure in India, irrespective of its allocation. Unless its volume is sufficient to meet the war expenditure in rupees incurred in India, the Government will under the present policy go on issuing more notes to meet the balance and inflation will continue to that extent. It is only when the diversion of purchasing power from the people to the Government equates the amount that the Government spends that inflation can be stopped. Even when this stage is reached, though prices may not rise further, they will not go down. The problem of the existence of large amounts of surplus currency already created will still remain, because that amount will still be in circulation. The withdrawal of such surplus currency from circulation or deflation will be another difficult process, to which reference has been made in the next chapter. If the above policy is carried out, the sterling received by us in London on account of the rupee expenditure made on behalf of His Majesty's Government will not be put in the Currency Reserve, but can constitute a real balance to our credit, which can be utilised after the war on national account. This problem will also be dealt with more fully in the next chapter.

(6) WAR FINANCE AND INDIAN STATES

The financial burdens of the War on India fall mainly on the people of British India. The new taxes are levied in British India only. Customs and Excise duties are the only taxes to which the people of Indian States contribute to the extent to which they consume dutiable goods. This is not large during normal times, it is smaller now because of reduction in imports and decrease in the yield from Customs duties. It is true that some Princes have been persuaded to contribute to the War Loans, or to various war funds, or to give gifts of war materials bearing their names, e.g., an aeroplane or an ambulance car and so on. Though such contributions are broadcast, they are not equal to the sacrifices which are imposed on the people of British India.

The indirect sacrifice due to inflation and rising prices is also not felt in the same degree by the people of Indian States.

It is well known that the States have followed an exclusive policy regarding essential goods by encouraging imports and prohibiting exports of such goods from their territory they have in most cases obtained a good supply for their population. The hoarding of essential goods against which we have several restrictions in British India can be done with impunity in some of the States. If it were possible to ascertain the actual price which the consumer has to pay in the States for essential goods compared with what he has to pay in British India, we shall have illuminating facts showing how the burden of inflation is partly avoided by the States. Prices are certainly higher than before in the States the point is that they are lower than in British India. To the extent to which there is an uneven distribution of essential goods between the States and British India, the burden on the people of British India in the shape of higher prices is greater.

In the proposed scheme of Federation under the Act of 1935 the States had an important place. If two Indians are sent to the War Cabinet, one has to be a Prince. In the future constitutional and political arrangements of the country the States will obviously figure as important parties in sharing the new powers. As against this, we have the present situation in which India is a party to a totalitarian war in which in the name of the Defence of India, but really also for the Defence of the Empire, huge expenditure is being incurred. Is it fair that the States should be the mere donors of gifts and subscribers to loans under the present conditions? The Defence of India includes the Defence of the Indian States. Under the existing treaties with the States, the Paramount Power has to protect them. Who is to bear the cost? Should the cost of defending the States be borne by them or the Paramount Power? It is well known that in the past the States were defended by the Paramount Power at their own cost. The question whether the cost of defending the States be borne by the people of British India admits only of a negative answer. In fact, however we find that substantially it is British India which bears the financial burden of the war.

Besides, it is common knowledge that there is a tendency among industrialists to start factories in the States in order to avoid Income Tax, Super Tax and E.P.T. It will not be surprising if some of the existing concerns in British India even

migrate to the States. It is well known that some States have adopted a policy of encouraging this tendency in the interests of their own people. The regulation of private investment in British India recently introduced will intensify the same tendency, thus defeating its main object.

One of the important and effective ways to increase the resources of the Government of India to prevent inflation is to ask the States to give regular war contributions which should in effect be in proportion to the burden on the people of British India. In order to raise these amounts the States should be asked to impose taxes and controls similar to those imposed in British India. At the same time, steps to raise more war loans in the States should also be taken. Such measures should bring in substantial amounts which would go far to provide the funds badly needed by the Government of India, and enable them to avoid further inflation, and at the same time remove the existing inequalities between different areas in the country.

(7) WAR STRATEGY ON THE HOME FRONT

The state of affairs described above has arisen because British India and the States have remained as separate entities for the purposes of economic controls and more so for war taxation. Even the Provinces are allowed considerable latitude in matters such as food and cloth control which adversely affects the entire price control policy. His Excellency the Viceroy emphasised the geographical unity of India sometime ago, the economic unity of India is no less important, particularly during the war and for the success of anti-inflation measures. For its recent anti-inflation measures by Ordinances, the Government of India have set aside all constitutional propriety. They should realise that the need for setting aside the excuse of treaty rights of the States in the matter of economic controls is more urgent. Just as war strategy in the field requires unified control, similarly war strategy on the home front requires unified control over the entire country particularly in economic matters, which will otherwise elude even the all powerful Government of India. In other words, neither the Provinces nor the States should be allowed discretion in shaping the economic policy in connection with the war in the interests of unified control, which alone can succeed. There should be the

task to obey and carry out willingly central policy both in letter and spirit. Irrespective of any constitutional impediments or the show of treaty rights, unless the Government of India are prepared to assume the responsibility for a unified policy of economic control throughout the country they cannot hope to succeed in their anti-inflationary efforts. Besides the administration of uniform measures of control throughout the country in this way this policy should also aim at the proper distribution of the direct burdens of war between the States and British India as explained above.

In our discussion of anti-inflationary measures, we have assumed that the Government of India will continue to shoulder the responsibility as hitherto of providing rupee finance for the British and allied governments. Though we do not agree that this is correct, we have further assumed that having undertaken the responsibility they will treat the financing of this expenditure in the same way as they do with reference to the expenditure charged to India. It is only by doing so that is by providing for this expenditure by means of taxes, loans and other methods suggested above including contributions from States, that the Government of India can hope to avoid further inflation.

If the Government of India are not able to achieve this goal namely of equating their monetary resources to the total war expenditure in India without resort to further inflation, they should make prompt arrangements with the British and Allied Governments by which the latter should find the rupee finance for their requirements by one or more of the accepted methods outlined above, and thus put an immediate stop to the unnatural and ruinous process of accepting payment for our goods in sterling and issuing notes in India. Further continuation of the existing policy must lead to the impression that the British Government have adopted the method of paying us in sterling on grounds of their own convenience and advantages¹ without regard to the inflation that is caused thereby in this country.

(8) PASSIVE ATTITUDE OF RESERVE BANK.

It is appropriate in this connection to refer to the passive attitude of the Reserve Bank of India regarding the problem of

¹ See chapter VI, p. 126.

inflation In its last annual report, the Reserve Bank observes that "the remedy for any inflationary tendency that the expansion of currency might have, must take into consideration the causes which are producing the increased demand for currency and these in present circumstances are not amenable to any action which the Reserve Bank can itself take" Surely, it was the business of the Reserve Bank to have pointed out the dangers of inflation inherent in the existing policy of financing the requirements of the British and Allied Governments and to have suggested the more natural and correct methods of financing the same by the adoption of which the present situation would have been avoided It is still within the power of the Reserve Bank to change its passive attitude and cry halt by asking for the desirable change in the present policy without any delay

VI.

STERLING ASSETS

(1) STERLING ASSETS OR STERLING BALANCES.

We have deliberately used the phrase *Sterling Assets* instead of *Sterling Balances* which is frequently used in this connection. The use of this latter phrase has led to a serious misconception regarding the nature and use of these resources as will be clear during the course of this chapter. These sterling resources are in the form of Assets of the Issue Department of the Reserve Bank of India, and unless we bear in mind this distinction, we are likely to be misled as will be pointed out later.

(2) PRESENT USE OF OUR STERLING RESOURCES.

We have seen above that instead of the natural and correct methods of payments for our goods and services, we are being paid in sterling. These sterling resources have been used mainly in two ways. Firstly to repatriate the sterling debt of India which stood at Rs. 469 crores in 1938-39. We have already seen how this has been by now largely paid up and whatever remains will be paid in a short time. The other use of the sterling resources has been to invest them in sterling securities and deposit the same in the Issue Department of the Reserve Bank against which rupee notes are issued in India. These sterling securities amounted to Rs. 422 crores on 26th March, 1943.¹ The amount goes on increasing every week and at the present rate of a crore a day the figure may grow very large, if the present financial policy is followed. The Reserve Bank also holds large balances

1. See p. 60 foot note for recent figures.

abroad in the Banking Department, these are mainly in sterling; they amounted to Rs 87 crores on 26th March, 1943, this figure includes cash and short term securities. A sum of £30 million was paid to the British Government out of our sterling assets in lieu of railway annuities which the British Government will pay on our behalf in future. Similarly arrangements were announced in the beginning of 1943 for the payment of Railway Debenture Stock of £20 million. The Chatfield debt of £8.5 million is also proposed to be liquidated as soon as possible.

(3) REPATRIATION OF STERLING DEBT

The repatriation of sterling debt is a desirable step inasmuch as the interest on the rupee debt created in its place will be paid in the country, and these resources will be available in future to finance our trade and industry. Objections were raised by Mr Jamnadas M. Mehta in the Assembly to the rates at which the different loans were repatriated, he pointed out how there was some loss to India in the process. Accepting that the arrangement could have been carried out at a more advantageous rate, the transaction must be considered beneficial to the country in the long run.

(4) PROBLEM OF THE FUTURE USE OF OUR STERLING ASSETS

The main question now is with reference to the use of the growing sterling assets in the Issue Department of the Reserve Bank. Sir James Taylor in his speech at the last annual meeting of the Reserve Bank in August, 1942 referred to the advantages of these assets to India. He pointed out how in his opinion with the help of these assets India would be able to make purchases of outside materials for her post-war reconstruction. Such purchases according to Sir James would incidentally help inevitable post-war depression abroad, and therefore India would be helping international post-war reconstruction at the same time¹. This has led to elaborate calculations in certain quarters as to the way in which these assets could be utilised. Safeguards have also been suggested against their possible depreciation.² The Federation of

1. Similar ideas were repeated by the Finance Member in para. 52 of his Budget Speech for 1943-44.

2 Cf 'India's Sterling Balances' by G. D. Birla

diversion of the sterling assets in the reserve for other purposes will involve a large currency manipulation with inevitable other repercussions. If for example, he transferred, let us say Rs. 100 crores worth sterling from the reserve for the Pensions Scheme, it would be necessary for him either to withdraw an equivalent amount of rupee currency from circulation, or to substitute rupee securities in the Reserve of the same nominal value, thus laying the Government of India open to the charge of creating credit inflation against which he has tried to argue in the Budget Speech. The same remarks would apply to the Reconstruction Fund, if it is created. Besides, on principle it is not proper to earmark assets which are used for one purpose for an entirely different purpose. One wonders whether this would be consistent with the Reserve Bank Act or with the principles of sound Central Banking. This is not to say that a Reconstruction Fund is not desirable—the above argument merely shows that the creation of such a Fund is not easy as it may appear at first sight.

Though the merits of these schemes have been discussed in the Legislature, the question of financing them in relation to our sterling assets has not received the attention that it deserves—a question which has led the Finance Member to make contradictory statements, which escaped the notice of the members of the Legislature.

Any one following the discussion on the use of sterling assets either in the proceedings of commercial bodies or of the Legislature or in the press is sure to be bewildered because of the widely different angles from which each party views the problem, without taking due note of the simple fact referred to above, that having been used as the legal basis of more currency in India, these sterling assets can be utilised only for a currency purpose and with a currency effect. The Finance Member has added to the confusion by his contradictory statements regarding the way in which the Pensions Scheme and the Reconstruction Fund are to be financed, and he has not allayed the anxiety of the public regarding the future utilisation of these balances by his declaration that it is essentially a post war problem, which cannot be tackled now¹

1. It is recently announced by some journals that the Pensions Scheme is to be put into operation. It is estimated that it will require

(7) THE OBJECT OF THE STERLING RESERVE.

In order to remove the prevailing confusion on the subject, and to attempt to foresee the probable circumstances in which we would have to deal with this matter after the war, a few elementary facts about our currency mechanism may be first recalled. The practice of keeping our currency reserve in sterling dates back to 1898-99, when the so-called Gold Standard Reserve was created to maintain the exchange value of the rupee, which was then fixed at 1s 4d. In practice, this was a Sterling Reserve, because so long as sterling was convertible into gold as it was in those days, it was considered immaterial if the reserve was maintained in sterling. Whenever there was an adverse balance of trade, or the exchange value of the rupee showed a tendency to fall, the reserve was utilised by selling sterling out of it in London for rupees tendered in India at the fixed rate. The effect of this was by contracting the currency to raise the value of the rupee to the fixed rate. In 1920, when the rupee was fixed at 2s gold, and when it was found that left to itself it would fall below that rate, the same process was adopted on a large scale. Sterling amounting to £55·4 million was sold in London at the new rate against rupees received in India, which were not reissued. The experiment failed and the effort had to be abandoned.

The Reserve Bank of India which is now charged with the function of maintaining the value of the rupee at 1s 6d has the same machinery at its disposal for carrying out this function. In other words, the chief object of sterling securities now accumulating in the currency reserve is for the maintenance of the exchange value of the rupee at 1s 6d. Unless it can be shown that part or whole of the sterling securities are not required for this purpose, it would not be possible to divert them to any other use as assumed in recent discussions¹ and even in Government pronouncements.

Though the sterling link of the rupee is in practice temporarily in suspense, we may assume that with the termination of

about £240 million. The way in which this amount is to be financed is not known. This seems to have escaped the attention of the critics of the scheme.

1 Cf 'India's Sterling Balances' by G. D. Birla

the war it will be restored. No new measures are necessary for this the legal forms have all been retained we are still in theory on the sterling exchange standard and with the removal of exchange control, it will again be in operation. The only alternative to this assumption is that the rupee will be allowed to function as an independent currency and will have direct independent relations with the future international gold unit of Bancor or Unitas and not through sterling. This would certainly be highly desirable, but it would be too much to assume its realisation in the near future.

(8) FUTURE EXTERNAL VALUE OF THE RUPEE.

It would be appropriate in this context to consider the future external value of the rupee, which has been fixed at 1s. 6d. sterling since 1931 and which the Reserve Bank is bound to maintain by law a law which cannot be changed without the consent of the Governor-General. With the memories of the rising exchange value of the rupee in the last war people are apt to believe that the rupee is at least not likely to fall in its external value in this war. They may overlook the fundamental difference, namely that we were thrown on to the silver standard in the last war because of the rise in the gold price of silver. This possibility has been removed in this war by the timely reduction of the silver contents of the rupee. The other difference is that we did not have that systematic and continuous dose of inflation in the last war with which we are now familiar in this war. The rupee has fallen and will continue to fall in its internal value the effects of this phenomenon on its external value are for the time being concealed by the operation of trade control and exchange control. The effects will inevitably assert themselves as soon as the controls are relaxed after the war because one of the essential conditions of peace will be restoration of international trade on as large a scale as possible.

(9) DETERMINATION OF EXCHANGE RATE.

How is the exchange rate between any two currencies not related to gold determined in practice? It is determined by the relative strength of the demand for and the supply of a currency in the foreign exchange market. The main cause of this demand

and supply is international trade. Such trade depends to a great extent on the internal prices in the countries concerned. If our goods are cheaper to the foreigner, he will buy more of them and vice versa. In other words, the internal prices of goods in different countries is an important factor affecting international trade, which leads to the demand for foreign currencies and the need for exchange. It is because of this that movements in the external value of a currency generally follow movements in its internal value, relative to the internal value of other currencies. Or, in other words, the ratio of exchange between two currencies tends to be the same as the ratio between their respective purchasing powers. This was the experience of European countries during and after the last war, when their currencies had lost their moorings because of inflation and their changing price-levels resulted in corresponding changes in their exchange rates. It is well-known how the external value of the German Mark fell so low that foreign tourists, say an American with a few dollars in his pocket, could obtain such an astronomical quantity of marks that he could live in the most luxurious style in Germany after the war or buy out anything in Germany which he fancied with ease. There are people in our country who also enjoyed a similar experience after the last war.

(10) FALL IN THE EXTERNAL VALUE OF THE RUPEE

Let us apply the same experience to our conditions. The rupee has begun to fall in its internal value because of inflation. There is no sign of putting a stop to the process. At the end of the war, when efforts will be made to restore international trade to its normal channels, the effect of the falling internal value of the rupee will assert itself on its external value. In other words, the external value of the rupee will fall in relation to those currencies whose internal purchasing power is relatively higher. It is possible that the foreign currencies may have also fallen to some extent in value, the main point is that the currency which has fallen more in its internal purchasing power will be at a disadvantage. The pound sterling did go down in value at the end of the last war, but the German mark went down much further with the consequence that one could buy large quantities of marks for a pound sterling.

(11) DEGREE OF FALL OF THE STERLING

The British price-level which was about 114 in 1941 was maintained at about 122 in 1942. The American price-level is about 100 and efforts are being made to maintain it at that level. The Indian price level was at 272 in March 1943. The U.K. has had a remarkable success during the present war in preventing a big rise in prices in spite of its colossal expenditure. The same applies to the U. S. A. These two countries have become wiser by the experience of the last war and have developed a monetary and financial technique by means of which they are able to prevent the fall of their currencies even during the war in spite of the unusual dimensions of their war expenditure. With the help of the same technique, they will be able to control their internal price-levels and therefore the exchange value of their currencies after the war. Before the present war in accordance with the Tripartite Agreement between the U. S. A., the U. K. and France, relative exchange stability of the currencies of these countries was achieved by the effective use of Exchange Stabilisation Funds. We may assume that in the interests of their own people and in the interests of world trade in which the U. S. A. and the U. K. are interested, they will succeed in the same effort after the war. It is not unlikely that the pound and the dollar may fall to some extent after the war what is of importance is the degree of such fall, and the rate at which the respective Governments will maintain their currencies.

The possibility of the U. K. having an adverse balance of trade after the war and her need to export more to meet her external liabilities are taken as factors which may lead to the depreciation of the sterling. But against the possibility of depreciating the sterling to achieve larger exports, the trend of present discussions¹ is in the opposite direction. Besides, the nature of her external liabilities, which are mainly in the form of sterling holdings of Empire countries, is such that it will help the post war reconstruction of the U. K. and enable her to achieve speedy recovery by ensuring large orders for its industries during the period of depression after the war.

1. See the following section on the International Gold Exchange Standard.

(12) INTERNATIONAL GOLD EXCHANGE STANDARD.

In view of the above considerations, we may assume that even if the pound sterling falls in its internal value compared with now, that fall will not be great, and that there is sufficient foresight, understanding as well as capacity in the U. K. and the U S A to see that the dollar-sterling relation is maintained at a reasonable level compared with the pre-war position. This view is confirmed by the recent discussions in England and America regarding post war plans for an international currency and allied problems. It is not possible here to discuss these plans. It is clear however, that timely steps are being devised to achieve post-war equilibrium in the monetary sphere and avoid the mistakes which involved the world into a currency chaos after the last war. Apart from the actual plans that may be evolved from these discussions, it is obvious that future equilibrium will depend on the position of the sterling and the dollar either in relation to a new international gold unit that may be contrived or in relation to each other. In other words, the effort will be to maintain the exchange value of the sterling in terms of gold and of the dollar at a reasonable level. Either sterling will be fixed at its pre-war (1939) level or in any case if a new level has to be fixed it will not be very much below that of 1939. It is to the interest both of the U K and the U. S A to do so. Having done so, effective arrangements will be made to maintain the new level and also to prevent changes in the exchange values of the currencies of other countries who may join the New Currency Union¹. In other words, the stability of exchanges similar to that achieved under the Gold Standard will be the goal. The difference will be that instead of the common link of gold as under the Gold Standard, it will be a commonly accepted link of 'Gold Exchange' in terms of a new international unit, be it a Bancor or a Unitas. Thus this will be in effect the extension to the international sphere of the system of Gold Exchange Standard that India had during the period 1899-1914, in which currency was given for gold, but gold was not given for currency, as is now proposed under the Keynes Plan.

The success of this proposed system will depend on the ex-

1. The membership of India in the Union is, of course, assumed.

tent to which the value of gold is maintained at a stable level. If either gold is allowed to fluctuate or the gold values of currencies are changed, we shall have the recurrence of changing price levels within different countries in order to achieve exchange stability in international relations. As the U. S. A. has the largest stock of gold and the U. K. has large gold mines within the Empire, the value of gold will depend on the policy of these two countries. The danger therefore is that the members of the proposed World Currency Union may find themselves at the mercy of these dominant partners, who have already arranged for a determining voice in the working of the proposed schemes.

(13) DEGREE OF FALL OF THE RUPEE.

If the present methods of inflation in India continue, our price-level will go on rising, and the internal value of the rupee will fall further. The existing gulf between the price levels of India and the U. K. will be widened with every dose of inflation, and whatever happens to the sterling this gulf may not be bridged. The inevitable consequence will be that the external value of the rupee will fall: it will no longer be 1sh. 6d., it may be much less: it will be about half this value with the present disparity of the price-levels of the two countries: the exact fall will be determined by the corresponding price-levels of the respective countries at the time: but that it will be great cannot be denied.

In this connection, it is possible to raise a theoretical objection that the base of the Index Numbers of the different countries whose price-levels are compared is not the same. As already pointed out before¹ even if it is possible to have more perfect data about the price-levels of different countries, the general tendency established here and the line of argument adopted in the light of the experience of the last war will remain true. It may be possible to show that the existing gap between the price-levels in England and India will be somewhat less if the base year for both countries is the same. If this adjustment is made, another adjustment should also be made in the interests of truth, namely that due to the fact that the Index Number of prices in India is calculated on the so-called controlled prices, which are more on

1. See foot note to Page 88.

paper than in operation. If the prices which people have to pay in the black market were taken into account the Indian Index Number would be much higher,¹ and the gap between the two price-levels would be wider. When the controls are removed it will be these free market prices which will assert themselves and have their due effect on the external value of the rupee.

(14) THE RESERVE BANK'S STATUTORY FUNCTION

The Reserve Bank is bound by law to maintain the rupee at 1sh 6d. The history of Indian currency shows that efforts are always made to maintain the rupee at as high a rate as possible in terms of the sterling. The advantages of this policy to British trade in this country are well-known. The question after the war will not be of raising the exchange value of the rupee as in 1920, the question will be of preventing its fall and maintaining its statutory rate. It will not be necessary for the authorities to enact a new law as in 1920, the existing law will be in their favour to repeat the operations with which the value of the rupee was sought to be raised in that year. The same policy will be enjoined on us by the proposed New World Currency Union in the interests of world equilibrium of exchanges. In other words, the Reserve Bank will in order to carry out its statutory duty, sell sterling for rupees at the statutory rate, though the current market rate would be much lower. The sterling assets of India which have been used as a legal basis for more currency now, will then be utilised to bring about less currency in the country. The value of the rupee, both internal and external, can be raised only by withdrawals of the excess currency in the country.

(15) DISPOSAL OF STERLING ASSETS

By selling sterling from the Issue Department of the Reserve Bank in London and by receiving rupees for the same in India, this object will be carried out. Rupees so received will be withdrawn from circulation, the corresponding amounts of sterling from the reserve will have been sold away at a loss. Compared with the then prevailing price of sterling in terms of the fallen rupee, the above operation will involve a big loss. In making

1 See footnote to Page 88

this attempt to bring the rupee back to its statutory rate, whether the Reserve Bank will succeed or not, is more than we can say now. It will only perform its statutory duty and it will succeed in the bargain in disposing of the sterling assets of the country which have been piled up out of the present resources of the country. This will not be the only result. The contraction of currency or the deflation which will thus be practised will result in low prices, depression and unemployment. The apparent prosperity which we see about us now will suddenly disappear. The mushroom companies which are growing everyday now may find themselves in difficulties and the country will be thrown into the depths of a severe depression.

(16) PRIVATE GAIN vs. NATIONAL LOSS.

The sterling assets will be obtained mainly by Exchange banks, or exchange speculators. These will be utilised to finance British imports into India. These may not necessarily be capital goods that we want they may also be competitive goods. It may be that some rich Indians who may send remittances to England by giving rupees here will be at an advantage as they will be able to buy their requirements in England at a cheap rate. But their individual gain will be at the cost of national loss. The sterling assets have been built up from the goods and services which we are now giving this is a big deduction from the current income of a poor country like ours with a deficit economy. Instead of receiving an adequate return for these assets, the country may find them illusory and a few individuals either British or Indian will reap a good crop out of this national loss by buying sterling at a cheap rate.

In this connection it is interesting to refer to the observations of the Finance Secretary in the Council of State made on 26th March 1943. He said —“The existence of external assets would provide for resumption of import trade and automatic contraction of currency. Increase in currency was therefore only a temporary phase.” This shows the consciousness of the point referred to above that the sterling assets cannot be used without a currency effect. The use of the assets in future will lead to contraction of the surplus currency which is the greater part of the existing volume of currency and this must lead to a sudden large fall in prices, leading to depression and unemployment as

pointed out above ¹

(17) ADVANTAGES OF THE PROPOSED CHANGE

We suffer now by inflation and high prices in financing British purchases ; we shall suffer later by low prices and deflation in maintaining the statutory exchange value of the rupee and in the process the much talked of sterling assets will disappear. If however, rupee finance is raised by the British here, they would have to pay interest to us in rupees , and for this they would have to nurse the Indian market and send goods required by us in future years. We would have the upper hand in trade negotiations, just as they had in the Indo-British Trade Agreement, when they could always play on the fact that we were in the need to export to the U K to make our sterling payments. The future would be thus safeguarded and the present evils avoided by adopting the natural and correct methods of financing British requirements in this country outlined above.

If however, the responsibility of finding the rupee finance for H M's Government is retained by the Government of India as hitherto, with the difference that the rupee resources thus required are obtained by diverting the existing resources of the people to themselves by taxes and loans aided by effective anti-inflationary measures suggested above, the same object would be served. Further inflation can be avoided if the rupee resources obtained by the Government of India are equated to the total rupee expenditure for the war in India. If this is done, the sterling payments made to us by the U K. will be a real balance to our credit , it will no longer be necessary to convert them into the Assets of the Reserve Bank of India. Such balances would

1 Whether according to the Finance Secretary's remarks, the sterling assets will be used for import of goods on private account or on national account is not clear. If the rupee falls in its external value as explained above, the import of goods will be on private account and therefore not regulated in national interests. If for the sake of argument we assume that the import of goods will be on national account, then the Finance Secretary's remark implies that the goods so imported will be sold to persons in the country and the rupees received in return will not be reissued, the process being similar in its effects as in the other case when the rupee was assumed to fall in its external value.

then be available for national use after the war unlike the present sterling assets.

(18) ADVANTAGES TO BRITAIN BY THE PRESENT METHOD

An interesting aspect of the existing arrangements is that the present use of our sterling assets by the repatriation of Indian sterling debt and by investment in sterling securities, serves as an anti inflation measure for the U K. By the first process large amounts of sterling are released for investment in British Defence Loans. By the second process India directly invests its sterling assets in British Loans. This very process leads to inflation in India by the issue of more notes. After the war by the process already explained these sterling assets will be released in the U.K. and will be available to help British trade and industry at a time when the war demands will have gone down and depression may have set in. At this juncture the release of these assets in London will therefore prove an anti-deflation measure for the U K. This very process will help to create deflation here in the effort to restore the exchange value of the rupee.

(19) APPEAL FOR OVERHAULING THE PRESENT POLICY

In other words, the whole policy regarding the use of our sterling assets is not in the interests of India now or in the future and should be changed to the more natural and correct method by putting the responsibility of finding rupee finance for their requirements on the British and allied Governments without a moment's delay. It is hoped that all concerned will carefully reflect on this and will realise that the sterling assets on the better utilisation of which there is so much thought and attention will really prove illusory and have the same fate as similar assets had in 1920 so long as the present inflationary methods continue. Instead of asking the Government of India to define their policy regarding sterling assets, it would be more appropriate to ask them to overhaul their present financial methods which are positively detrimental to the interests of the country.

The alternative to this is for the Government of India to obtain the rupee resources required for the entire war expenditure in India on their own responsibility by diverting the existing resources of the people to themselves by adopting the various methods suggested above. To the extent to which they fail in doing so inflation with all its evils must continue.

VII.

CONCLUSIONS

(1) ESTIMATE OF TOTAL FINANCIAL BURDEN ON INDIA.

In estimating the total financial burden of the war that India bears, the following factors must be taken into account —

(1) The additional revenue which the Government of India have raised since the War Compared with the budget estimates for 1939-40, which were made before the war, we find that the total additional taxation amounts to Rs 250 crores¹ Including the arrears of Rs. 100 crores for E. P. T. recently announced, this will be Rs 350 crores

(2) The additional rupee debt incurred during the period which is estimated to amount to Rs 545.63 crores by the end of

1		Figures in crores of Rs		
		Total Tax Revenue	Excess over 1939-40	B. E.
B. E.	1939-40	74.7		
Actuals	1939-40	85.0	10.3	
"	1940-41	89.9	15.2	
"	1941-42	118.7	44.0	
B. E.	1942-43	144.3	69.6	
B. E.	1943-44	185.8	111.1	
				250.2

The total expenditure on Defence since the War up to the end of 1942-43 was Rs 553 crores. With the Budget Estimate of Rs. 200 crores for 1943-44, this will amount to a total of Rs. 753 crores. The great difference between this and our figure of increase in revenue is explained by the fact that in the above estimate, we have taken into account only the additional tax revenue.

1943-44 The revenue deficits during the same period amount to Rs. 139 crores excluding the provision for debt reduction.

(3) The rupee finance provided by the Government of India for the remaining war expenditure in India, which could not be met from the above two sources. As no systematic data are published for this part of the war expenditure, which is excluded from our budgets, we have to infer the same from whatever information is available. We find that sterling payments made by His Majesty's Government amounted to Rs. 505 crores up to the end of December 1942. We have estimated the figure up to the end of 1942-43 at Rs. 555 crores, and for 1943-44 at Rs. 300 crores. If the war is intensified in the East as is likely in the near future, this figure would be considerably exceeded.¹ This shows the amount of war expenditure incurred by India on behalf of the U K. or the amount of rupee finance that India had to find for the U K. We have already shown how this is the main cause of inflation in India. The effects of inflation on the economic life of the country and the inequitable burden that it imposes on the poor and middle classes, cannot be calculated except in terms of the index number of prices, which indicates the extent to which the people have to bear a diminution in their standard of life. The Index Number as we have seen is continuously on the rise. The fact that some rise in prices was inevitable even in the absence of inflation must be taken into account in forming an estimate of this phenomenon. The experience of the U K. and the U S. A. shows that such a rise need not have been large, if inflation were avoided, and an anti inflationary policy were adopted in time.

(4) The suffering which must inevitably follow after the war when deflation takes place mainly as a result of the inflationary policy now in vogue, when therefore we shall have a

1 These estimates were on the safe side. The Report on Currency and Finance just issued by the Reserve Bank of India shows that the amount of sterling received by the Government of India from H. M.'s Government in lieu of rupee expenditure incurred by them in India on their behalf was Rs. 587 crores upto 31st March 1943, as against Rs. 555 crores estimated by us. Similarly the amount of such expenditure for 1943-44 is put at Rs. 346 crores as against Rs. 300 crores estimated by us.

sudden large drop in prices, and consequent depression and unemployment

(5) As against this, we have the advantage of the repatriation of sterling debt, which removes the need for sending sterling remittance to the U.K. for the payment of interest. This advantage could however have been obtained by us in any case by means of the sterling due to us for our excess of exports during the war, as already explained before. The claim that we have been freed from our debtor position because the U.K. pays us in sterling is not justified.

(6) We have in addition the Sterling Assets in the Issue Department of the Reserve Bank of India. It is not clear whether we shall get imports of goods against these assets on national account or on private account. Our analysis has shown that these assets will go into the hands of private parties and the imports will therefore not be on national account. The advantages of these assets have thus important limitations.

(2) MYTH OF BRITISH GENEROSITY TO INDIA

These assets represent a deduction from the current national income of the people of India which is admittedly small. They represent therefore the immediate sacrifice which the people of India have undergone to finance the war expenditure in India incurred on behalf of the U.K. Apart from the sacrifice shown by this figure, there is the invisible sacrifice of inflationary effects which as said above cannot be ascertained. If the people of India are to have an adequate return for this loan to the U.K. the goods to be received in future should be determined in such a manner that they may help the economic development of the country in future and not come in its way. As the possibility of regulating the imports of goods from the U.K. or other foreign sources in lieu of these assets is remote, we may take it that the return will not be determined by our national requirements. The much talked of advantages to India of these assets may therefore prove illusory.

In any case it is obvious that the sterling assets have grown and are growing not because the U.K. pays for the defence of India, but because India now pays in rupees for the Imperial

expenditure incurred in India for the defence of the Empire, and suffers in consequence by inflation. And when we visualise the important limitations on the use of these sterling assets on national account in future, and in any case the inevitable depression from which we shall suffer when these assets are used, due to consequent contraction of currency we may well wonder at the ingenuity and the audacity of the myth of British generosity to India in the financial sphere. And further when we remember that the method of paying us for British expenditure in India is so contrived that not only does it cause no disturbance to the financial arrangements of the U.K., but it also acts as an anti inflation measure for the U.K. now and will act as an anti deflation measure for her after the war we must consider the propaganda now carried on about this myth remarkable in its effort to conceal the true implications of the financial arrangements between England and India for the war

(3) WHITHER THE FALLING RUPEE?

In order to prevent the fall in the value of the rupee because of inflation, we have suggested methods of rupee finance for His Majesty's Government, who should raise rupee loans in India from the people, or from the Government of India. If however the Government of India continue to provide the rupee finance to U.K. they should limit the same within the resources that they can obtain by means of taxes and loans as suggested in the Economists Manifesto. At the same time various anti inflation measures outlined above¹ should be adopted on a countrywide basis in which the Provinces and States must co-operate in carrying out the policy laid down by the Centre.

The Government of India have shown their inflation consciousness by the various anti inflationary measures they have taken or announced since the last budget was passed. The E.P.T Ordinance for the recovery of large arrears, the regulation of private investment, the banning of forward transactions in cotton, seeds and bullion, the control of the prices of cotton and the scheme for the production and distribution of yarn and cloth are all steps in the right direction however belated. Having allowed inflation to develop to the present extent, the successful introduc

1. See Chapter V

tion of these measures has become more difficult. The test of the success of these and other anti-inflationary measures is whether they are effective in diverting sufficiently large quantities of purchasing power from the people to the Government from time to time throughout the duration of the war, to enable the Government of India to finance the total war expenditure in India including that for the U.K. and the Allies, thus putting a stop to the issue of new money or inflation. Unless the Government of India are able to achieve this goal or transfer the responsibility of obtaining rupee finance required by His Majesty's Government to them, inflation will continue. The new measures may reduce the pace of inflation for a time, but are not adequate to stop the inflationary trend as is evident from the continuous increase in currency. In consequence, the falling rupee continues to fall. The effort to control the prices of essential goods like food and cloth may prove beyond the capacity of the Government themselves if the inflationary methods of finance continue. So long as the floodgates of inflation are open, the dams of anti-inflationary measures will remain weak to resist the flow. Unless these dams are built on such sure foundations as the people's goodwill and active co-operation, they will not be able to stop the flood of inflation, and the question 'Whither the Falling Rupee?' will remain unsolved.

(4) INCREASE IN PRODUCTION

Those who have suggested increased production as the only remedy for the prevailing scarcity of goods have failed to grasp the working of the inflationary process. Increased production is certainly desirable and should be undertaken wherever possible. But no one has been able to show how we can have under present conditions sufficiently large production to justify the growing volume of currency. The gross inequity of the inflationary methods of finance cannot be concealed by emphasising the obvious need for more production in the country, the scope for which is so limited that not even the impetus of the prevailing high prices has been enough to bring forth the requisite resources and organisation for that amount of production which may restore economic equilibrium in the country. To harp on this improbable goal at the moment is to wink at the evils of inflation.

and thus encourage the Government in a policy which is universally condemned. Those who dislike Government controls should realise that they are inevitable the correct attitude for them is to face the situation and see that such controls are carried out in the best interests of the country

(5) ANTI INFLATION OR DEFLATION ?

At the same time those who are talking of deflationary measures in face of the continued expansion of currency without any effort on the part of the authorities to withdraw the surplus currency from circulation, are indulging in a gross economic fallacy by which it is hoped the public will not be misled in spite of organised propaganda. There is a distinction between anti inflationary measures and deflationary measures. The former prevent the growth of inflation the latter bring about the opposite process by withdrawal of currency from circulation. The former would prevent a rise in prices the latter would bring about a fall in prices. A reduction in the high price level brought about by preventing speculation is not deflationary in the above sense. It is an anti inflationary measure inasmuch as it blunts the speculative edge of the inflationary rise in prices. But such efforts do not effectively prevent inflation.

(6) THE POLITICAL FACTOR VS. THE ECONOMIC FACTOR.

The various measures suggested above, of course, presuppose an understanding of their aims and consequences by the people of the country without whose full co-operation they cannot be achieved. They also presuppose the proper vision on the part of those in power and courage to conceive and adopt a policy which will disturb vested interests, but which will at the same time save the future of the millions of this country. Such a vision and such a courage may not be expected of the Government of India as at present constituted. It is true that these measures require a strong National Government which can act with the support of the people and whose appeal to their patriotism can succeed. To the many arguments for a National Government advanced by politicians in recent times, this analysis supplies a potent economic argument, whose validity and reasonableness will not be easily questioned. The economic factor may in the long run prove more

powerful than the demand of politicians. There are known ways of silencing politicians; the economic factor cannot be silenced. The cries of inflation which are already heard in every home in this country in the form of unduly high prices will grow louder and louder as days go by, if the present reckless policy is continued. The pressure of inflation will inevitably lead to hunger and starvation and will pave the way for forces whose might may not be easy to control even by the powerful armaments in the hands of the largest number of white troops ever stationed in this country. Even from the selfish point of view of maintaining in India an effective base against the Japanese, the British and American authorities will, it is hoped, realise in time the urgent need for preventing this increasing menace before it is too late. For, the effectiveness of India as a base must diminish with the increase of inflation and consequent economic chaos within the country. The dilemma is to solve the political deadlock and enlist the co-operation of the people to prevent inflation and thus to help the war effort; or to continue the present methods of finance leading to the pauperisation of the people which must inevitably come in the way of the war effort.

The need for effective anti-inflationary measures to help the war effort has at last been realised. The consciousness to solve the political deadlock and enlist the co-operation of the people in the anti-inflationary drive may not arise till in actual practice the failure of the drive under the present conditions is experienced. Delay in such cases is dangerous, there has already been great delay in the Government of India developing inflation-consciousness, let them not increase their own difficulties to the point of failure by further delaying the effort for enlisting the peoples' goodwill and co-operation in carrying through the necessary anti-inflation measures. At the same time it is to be hoped that they will not play with palliatives in their desire to make a show of winning the peoples' goodwill. Political palliatives under the present conditions must prove more irritating than successful and will widen the gulf that separates the rulers and the ruled instead of bridging it effectively for winning both the war and the peace.

APPENDIX I

MANIFESTO BY INDIAN ECONOMISTS ON THE RECENT ECONOMIC POLICY OF THE GOVERNMENT OF INDIA

(Published on 12-4-1943)

The rapid rise in the general price level during the past two years and the enormous expansion of currency in India are, we feel, causally related. The unprecedented expansion of currency since the war began is due chiefly to the system adopted for financing the large British and other Allied purchases in India, under which the Government of India accepts payment in sterling and provides rupees in exchange. For all these purchases India acquires, under present arrangements, sterling assets in London and against these there occurs an expansion of currency in India.

The provision of internal finance in India for these purchases is a necessary concomitant of this accumulation of sterling assets in London and the responsibility for this financing falls on the Indian Government in the same manner as that for any part of the expenditure included in its regular budget. The failure of the Government of India to recognise this fundamental and essential fact has prevented it from taking the proper view of the economic and financial situation in the country.

The Government seems to act as if it is enough for it to take care of its own budget deficit while meeting the needs of the British Government by printing more notes. This is a grave misreading of the whole situation and has resulted in an ever increasing expansion of currency unrelated to the needs of internal production and trade. As a result, the inflationary spiral is already at work in India.

The net inflationary gap in India's finances, counting in the finance made on behalf of His Majesty's Government, is thus being wholly filled by the creation of more currency. The inflation in India is, therefore, a deficit induced fiat-money inflation. It is the most disastrous type of inflation. The repatriation of India's sterling obligations does not act as an anti-inflationary factor, except to the extent to which the rupee counterparts are taken up by the public, but this has so far been only small in proportion.

The increased liquidity preference of the public, which is at present tempering the rise in prices, cannot be expected to last long with a continuously rising price level. The experience of many European countries after the Great War emphasises the danger of counting on a continuance of this phenomenon. It is clearly a temporary phase and with a further rise in prices a preference for holding commodities instead of money might suddenly manifest itself.

Inflation is the most iniquitous way of distributing the war burden and usually involves large transfers of wealth from the poorer and the middle classes to the richer classes. It is also undesirable because it increases the cost of war and impairs the war effort by hindering production and distribution. Its consequences to economic society are immediately felt, it, however, also holds the threat of bringing about later, political consequences of an even graver nature.

We earnestly feel that immediate and drastic measures to check inflation are called for. In this connection we urge on the Government of India the primary necessity of closing the 'gap' by increased taxation and borrowing. Taxation, in our opinion, should be raised to the highest practicable pitch, adjusted to shoulders that can best bear it. We suggest a much steeper progression in income tax rates, the laying of a maximum limit to individual consumption, income and absorption of all profits above a limit, either in tax revenue or to be impounded into special loan contributions. To increase the volume of borrowings to the required level, it is necessary to institute a comprehensive scheme of compulsory savings as well as a rigid control of all investment outlets.

This programme should be brought into effect with great rapidity. However it will take some time before the inflationary gap is completely closed and the total currency in circulation is to-day already greatly redundant, even at the existing high prices. To tie up this vagrant purchasing power we propose the immediate initial steps of a blanket control of all prices followed by a strict examination of all later allowable increases.

In order to make this price control measure effective a policy of centralised supervision and direction of productive effort will be necessary. This will in its turn involve equally strict regulation of transport and distributive machinery on a national scale. A rationing of the essential necessities of life should be undertaken to as large an extent as possible. An effective control of prices will involve a wage stop but this will mean no hardship as long as the price rise is stayed. An equally strict profits stop is indicated as a corollary of this policy as well as independently on account of financial considerations.

In our opinion, only such a comprehensive view of economic policy is capable of averting the grave economic, political and social consequences of the continuance of the present process of inflation. We would also emphasize that the total liabilities undertaken by the Government of India, whether on their own account or on account of the British and Allied Governments, should not exceed the resources that they find possible to raise in pursuance of the policy outlined by us.

V. G. KALE, Formerly Professor of Economics, Fergusson College, Poona. President, Indian Economic Conference, 1928. Member Tariff Board, 1923-25.

P. A. WADIA, Professor of Economics, Wilson College, Bombay

K. T. SHAH, Formerly University Professor of Economics, Bombay University. Secretary National Planning Committee.

C. N. VAKIL, University Professor of Economics, Bombay University. President, Indian Economic Conference, 1934.

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- V Y KOLATKAR, Principal and Professor of Economics, Commerce College, Baroda
- D G KARVE, Principal and Professor of Economics, The D E Society's College of Commerce, Poona

APPENDIX II

A NOTE ON YARN AND CLOTH CONTROL

Finding that its original standard cloth scheme formed in 1941, by which the mills had undertaken to reserve 60% of their productive capacity for Government orders, was making no impression on the market and that it had failed, as Mr Hydari said,

"to provide cloth either in substantial quantities or at a constant and a low price the Government of India has come out with a new scheme, bolder and more comprehensive. The scheme has not yet taken complete shape, and is likely to undergo substantial modifications. But its broad features, as it stands to-day are described below —

(a) The quantity of standard cloth is to be substantially increased. The annual production of standard cloth has been fixed at 2,000 million yards. The mill industry has agreed to reserve 50% of its capacity for this production, and to put on the market 500 million yards in three months. A very low margin of 1½% profit is to be allowed to the millowners on this cloth, and the final consumer will not be required to pay more than 6% over its cost of production.

(b) Under the present conditions of demand, the production of standard cloth cannot, by itself suffice to bring down substantially cloth prices. It is, therefore, proposed to have a full control over the prices of the entire cloth and yarn production for the home market. Both the wholesale and the retail prices of cloth are to be fixed. In order that the consumer may not be misled the fixed retail prices will have to be marked on the cloth by the manufacturers.

(c) One of the most effective devices used to defeat control is to hoard the goods, and thus create an artificial scarcity. To defeat this practice, the Cotton Cloth and Yarn Order issued on 16th June 1943 lays down definite periods, during which the manufacturer the wholesaler and the retailer must dispose of their stocks. The days within which the cotton goods must be sold, have been laid down at 30 (extended to 45, if the cloth is not in bales) 90 and 180 days from the date of packing respectively. All cloth and yarn produced after 31st July have to be marked by the manufacturer with the date of packing. Limits have also been placed on the total stocks of cloth and yarn which can be held by a manufacturer. Cloth and yarn manufactured before 1st August, 1943 have to be sold, if in full bales by 31st August, and by retailers before 31st October.

(d) The whole scheme will be of no use if a determined effort is not made to keep down the prices of the materials required by the industry. The Government has assured the industry

that all possible measures will be taken to control the prices of cotton, fuel and millstores. Control is at present already operating in certain spheres, e.g., cotton movements are regulated, futures in raw cotton and cotton yarn have been banned, fair prices have been announced for cotton, the imports and distribution of millstores are regulated. This control will be extended. No guarantee, however, of keeping the cost steady through subsidies as in U S A has been held out. With the Government's present food policy, the wage bill forming an important part of the cost of production in textile industry will go on increasing, and the cloth prices may have to go on rising in consequence.

(e) One of the greatest grievances of both the Indian consumer and the textile industry has been the Government's policy of allowing increased exports when the home consumer himself is starved. The appointment of a non-official Export Sub-Committee, which is to be consulted by the Textile Commissioner and the Central Government on all matters regarding exports of cloth and yarn, may alleviate the widespread anxiety of the same policy being persisted in.

(f) In order to increase production, a three shift working and fewer holidays are recommended. Rationalization is also contemplated, and the Textile Commissioner has been empowered to order any manufacturer to manufacture only certain classes of cloth and yarn and in particular quantities.

(g) The Textile Commissioner is to work in consultation with a Textile Control Board which consists mainly of representatives of the Industry and is presided over by a non-official Chairman.

CRITIQUE OF THE SCHEME

The immediate effect of these measures has been that there has been a general drop of 40 per cent in the wholesale prices of cotton goods which had nearly increased by six times in most cases. The new level has not fully reached the retail trade, but may do so in course of time. Part of the original increase was obviously due to speculation and hoarding of stocks, this has been now removed. The new price level is however sufficiently high and roughly corresponds to the degree of inflation in the country. It is widely believed that it will not be possible to lower

the prices from this level, which means that the consumer will still have to pay 3 to 4 times the former prices for his cotton goods.

The Scheme has led to considerable controversy among the trade, who feel that they do not have adequate voice in the control. A strong organisation of different types of cotton goods traders has come into existence, whose object among other things seems to be to show that they were not responsible for the former peak levels in prices, and that the export trade is mainly responsible for the same.

It is too early to judge whether the Scheme will lead to (a) increased production, (b) substantial reduction in exports, and (c) a reasonable price for the local consumer. If all the parties concerned are actuated by a real desire to help the poorer section of the population with regard to their cloth requirements, the success of the scheme can be assured. Unfortunately there is not yet enough evidence to show whether the parties are likely to put aside their own considerations in the larger interests of the country

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